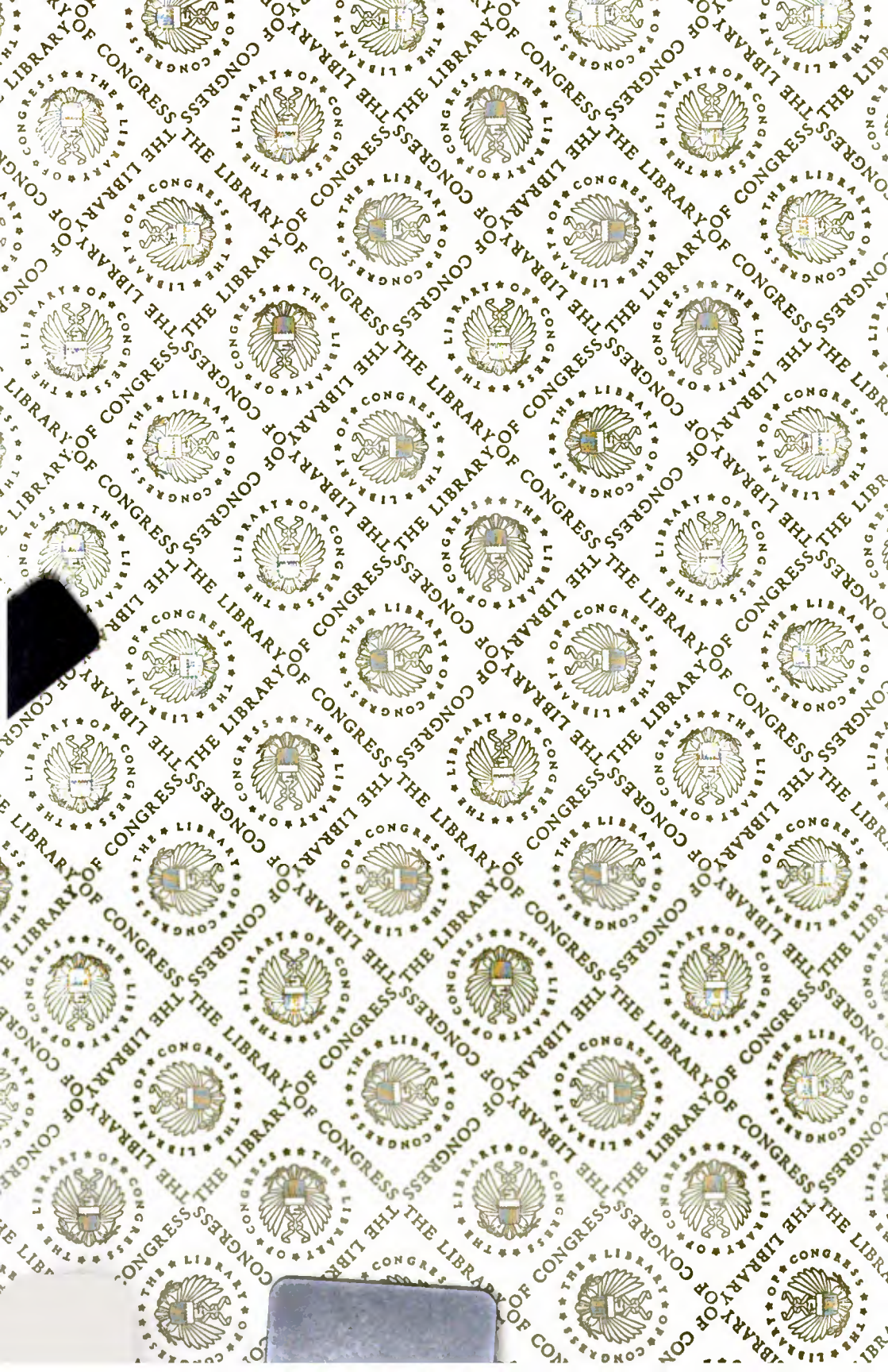
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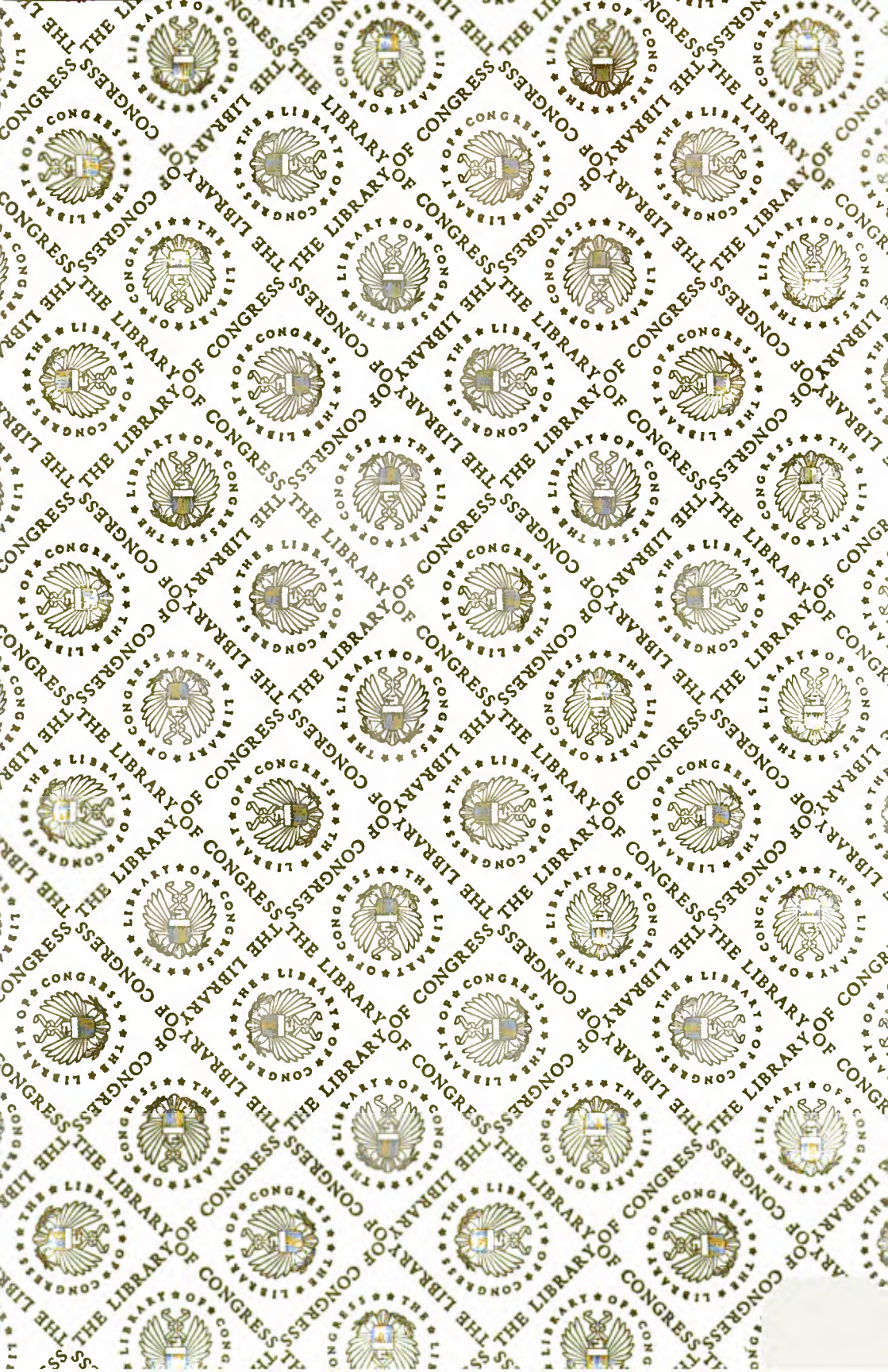
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FAIRNESS AND VOLUNTARY ARBITRATION ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

ON

H.R. 534

JUNE 8, 2000

Serial No. 94

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE

65-871 WASHINGTON : 2000

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402

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FAIRNESS AND VOLUNTARY ARBITRATION ACT

THURSDAY, JUNE 8, 2000

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW,
Washington, DC.

The subcommittee met, pursuant to call, at 10:45 a.m., in Room 2141, Rayburn House Office Building, Hon. George W. Gekas [chairman of the subcommittee] presiding.

Present: Representatives George W. Gekas, Lindsey O. Graham, Steve Chabot, Mary Bono, Jerrold Nadler, Tammy Baldwin, and Melvin L. Watt.

Also present: Representative Robert C. Scott

Staff present: Raymond V. Smietanka, subcommittee chief counsel; Susan Jensen-Conklin, counsel; Robert N. Tracci, counsel; Brie Harlow, staff assistant; Diana Schacht, Full Committee deputy staff director and chief counsel; David Lachmann, minority professional staff member; and Michone Johnson, counsel.

OPENING STATEMENT OF CHAIRMAN GEKAS

Mr. GEKAS. The hour of 10:45 having arrived, the committee will come to order. The rules of the House, and therefore, the rules of the committee require the presence of two members of the committee in order to constitute a hearing quorum. What we have done by hitting the gavel is to keep faith with our theme of opening every committee meeting on time. After 5 years we have succeeded in that. Unfortunately, many times we have to recess until the appearance of the second member. But we now have the lady from California Mrs. Bono, who is not only a projector and sponsor of the legislation at hand, but is a member of the committee. We have a quorum of—the gentleman from South Carolina is here, Mr. Watt, and the gentleman from Virginia, Mr. Scott, is here.

[The bill, H.R. 534, follows:]

106TH CONGRESS
1ST SESSION

H. R. 534

To amend chapter 1 of title 9 of the United States Code to permit each party to certain contracts to accept or reject arbitration as a means of settling disputes under the contracts.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 3, 1999

Mrs. BONO introduced the following bill; which was referred to the Committee on the Judiciary

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A BILL

To amend chapter 1 of title 9 of the United States Code to permit each party to certain contracts to accept or reject arbitration as a means of settling disputes under the contracts.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Fairness and Voluntary Arbitration Act".

SEC. 2. ELECTION OF ARBITRATION.

(a) SALES AND SERVICE CONTRACTS.—Chapter 1 of title 9 of the United States Code is amended by adding at the end thereof the following new section:

"§ 17. Sales and service contracts

"(a) For purposes of this section, the term 'sales and service contract' means a contract under which any person (including any manufacturer, importer or distributor) sells any product to any other person for resale to an ultimate purchaser and authorizes such other person to repair and service such product.

"(b) Whenever a sales and service contract provides for the use of arbitration to resolve a controversy arising out of or relating to the contract, each party to the contract shall have the option, after the controversy arises and before both parties commence an arbitration proceeding, to reject arbitration as the means of settling the controversy. Any such rejection shall be in writing.

"(c) Whenever arbitration is elected to settle a dispute under a sales and service contract, the arbitrator shall provide the parties to the contract with a written explanation of the factual and legal basis for the award.".

(b) TABLE OF CONTENTS.—The table of contents for chapter 1 of title 9, United States Code, is amended by adding at the end thereof the following new item:

"17. Sales and service contracts."

SEC. 3. EFFECTIVE DATE.

The amendments made by section 2 shall apply to contracts entered into, amended, altered, modified, renewed, or extended after the date of the enactment of this Act.

○

Mr. WATT. And I am not from South Carolina.

Mr. GEKAS. I wasn't mentioning you. I thought I saw someone from South Carolina. Now I see someone from North Carolina. The committee——

Mr. WATT. But you do have a quorum. You are batting 1,000 on that one.

Mr. GEKAS. The committee will come to order. And we will proceed with the business at hand. The subject matter, as everyone knows, is arbitration, and arbitration has taken a heavy role in the work of the Congress over the years. The Congress has perceived over the years in different ways, over decades really, the necessity and the utility of using the arbitration methodology for the purpose of resolving disputes. It has so recognized it that it has passed spe-

cific statutes that authorize, and in some cases mandate, the use of arbitration for resolution of disputes.

Where it applies with respect to the economic business of automobiles and dealerships and manufacturers is where the problem focuses today. This committee and this hearing will be focused on what, if anything, can be done about what is perceived in some quarters to be an imbalance of bargaining power and the utility of using the arbitration methodology within the industry itself, and that is where we are.

[The prepared statement of Mr. Gekas follows:]

PREPARED STATEMENT OF HON. GEORGE W. GEKAS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA, AND CHAIRMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Today the Subcommittee is considering H.R. 534, a bill to amend the Federal Arbitration Act to permit each party to a sales and service contract to elect or reject arbitration as a means of resolving disputes under the contract.

Arbitration is an increasingly common form of alternative dispute resolution where parties submit the adjudication of their contractual claims to a neutral arbitrator. While arbitration often decreases the costs of litigation, parties are required to relinquish many of the formal procedural safeguards of the litigation process.

Motor vehicle dealers in particular have complained that manufacturers often require that they accept "take it or leave it," form franchise agreements containing mandatory binding arbitration clauses. These mandatory arbitration clauses often place dealers in the position of having to forego state legal protections designed to remedy the disparity in bargaining position between dealers and manufacturers. The bill would change this by making arbitration between motor vehicle dealers and manufacturers a voluntary choice.

Since passage of the Federal Arbitration Act in 1925, the Congress has formally encouraged alternative dispute resolution to relieve court congestion and reduce the cost of litigation. The federal courts have also endorsed alternative dispute resolution, consistently enforcing arbitration agreements and interpreting the Federal Arbitration Act to preempt state law.

This Subcommittee has long sought to encourage arbitration and other forms of alternative dispute resolution. It will continue to do so. We must also continually reassess the efficacy of binding arbitration clauses to ensure that the decision to arbitrate remains a voluntary alternative.

We look forward to hearing from two panels of distinguished witnesses who will provide the Subcommittee with an insightful range of views on these important issues.

Mr. GEKAS. We would yield to the lady from California, chief sponsor of the bill, for the purpose of an opening statement. And we acknowledge the lady from Wisconsin as constituting another member of the committee and the quorum is intact. The lady from California is recognized for an opening statement.

Mrs. BONO. Mr. Chairman, thank you for holding this hearing today on H.R. 534, the Fairness and Voluntary Arbitration Act. I appreciate the time and energy you and your staff have spent to ensure that this legislation has a fair hearing. I would also like to thank Senator Feingold, an original cosponsor of the Senate version of this legislation, for appearing as a witness today in support of this bill.

I have introduced H.R. 534 in order for auto dealer franchisees to have the right to control some aspects of their own businesses. The reason for this legislation is to add an element of fairness to the auto industry. For many years auto dealers have had to live under the explicit regulations contained in the various dealer franchise agreements that are written by the auto manufacturers and delivered to over 20,000 auto dealers in the United States.

The biggest problem for auto dealers is that there is very little in the way of legal recourse if a dispute develops between the auto dealers and the manufacturer. If a legal dispute develops, the dealer cannot enter into litigation like so many other businesses, but must submit to binding arbitration. Whatever agreement results from the arbitration session becomes the final judicial decision. Unlike litigation, there is no chance to appeal and no ability to present new or even better evidence. Generally arbitrators are not bound by State law in their decisions; therefore, arbitration allows the manufacturers to prevent State laws from applying to dealers. These mandatory binding arbitration provisions also force dealers to relinquish forums otherwise available under State law, such as State courts and many other well-established boards that regulate both the dealer and the manufacturer.

The two issues that are before this committee today are whether auto dealer franchisees are being treated in a fair manner and whether mandatory binding arbitration contracts are the most equitable way of doing business. Current law is not acceptable because binding arbitration is forced on the dealer franchisee by the manufacturer. In most cases the dealer franchise agreements are extremely one-sided. The dealer is completely dependent on the manufacturer for a product inventory and in many cases accessories and miscellaneous parts, and there is no room for contract negotiation or hesitation.

The history of arbitration goes back to Congress's enactment of the 1925 Federal Arbitration Act. While this did not expressly preempt State arbitration issues, many of the State small business protection laws were effectively invalidated through a series of Supreme Court cases over the years. As a result, auto manufacturers preferred to use the fastest and least expensive method of arbitration to resolve its disagreement with its dealers. Manufacturers continued using arbitration because their one-sided contracts made it virtually impossible for the dealer to win a legal dispute.

H.R. 534 simply creates options for the dealer. This bill merely prevents the manufacturer from imposing mandatory binding arbitration as the sole means of resolving a dispute in sales and service agreements. As this bill moves closer to a vote, I believe that matching the language of this legislation with that of its Senate counterpart will simplify the legislative process as we move closer to passing this bill into law. Therefore, I have drafted an amendment in the nature of a substitute that will match the Senate version of this legislation.

Thank you again for the opportunity to participate in this hearing and I look forward to hearing the witnesses' testimony.

Mr. GEKAS. We thank the lady. Let the record indicate that the gentleman from New York, ranking member of the minority, is present, Mr. Nadler, who seeks time for an opening statement.

Mr. NADLER. Thank you, Mr. Chairman. Mr. Chairman, today we consider legislation to protect the rights of auto dealers and other resellers of products and services from the expanding use of binding arbitration clauses in contracts. This committee has long been sensitive to the need to ensure that no one is deprived of available legal remedies, but that alternative dispute resolution methods such as arbitration be made available on a consensual basis as a

means of conserving judicial resources, encouraging the expeditious settlement of disputes, and minimizing litigation. The ADR Act alternative dispute resolution is available, but Congress chose as a matter of policy to ensure that arbitration was voluntary. Similarly, Chairman Gekas has introduced legislation setting up a new pilot project in the Merit Systems Protection Board to encourage ADR. That bill has been carefully drafted to ensure that the policy of voluntary arbitration remains undisturbed.

That is a sound policy, and I commend the chairman and our colleague from California for working to advance it.

I am, however, concerned that this legislation now before us does not address other aspects of this problem which affects an even larger number of Americans: The growth of binding arbitration clauses not only in franchise agreements but also in consumer contracts and service agreements, credit agreements and the like. I hope that we keep in mind as we examine this legislation that the issue has broader implications which must be considered as well.

I thank you, Mr. Chairman. I yield back the balance of my time.

Mr. GEKAS. Thank you. I thank the gentleman. And we recognize the gentleman from South Carolina as attending this committee meeting, the gentleman Mr. Graham. Let the record so indicate. And we will proceed. We have the good fortune of having two of our colleagues from the so-called other Chamber, and we are indeed ready and willing to listen to their testimony. Senator Feingold is the Junior Senator from Wisconsin who serves on the Judiciary Committee. He is a Harvard graduate, an Oxford Rhodes scholar and University of Wisconsin is also in his background. He served in the Wisconsin Senate before coming to the Congress and has been in the Congress since 1992.

We welcome your testimony after the introduction of your colleague, Senator Sessions, who is a former U.S. Attorney. He is on the Armed Services Committee in the Senate. But to me, the yeoman's service that he has performed with respect to the emerging bankruptcy reform legislation, deserving my utmost personal commendation.

So we are ready to proceed now to hear their proposals and their critiques of the current legislation. We will begin with Senator Feingold.

STATEMENT OF HON. RUSSELL FEINGOLD, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Mr. FEINGOLD. Thank you, Mr. Chairman, and thank you, Mr. Ranking member, members of the committee. I am especially pleased to be here before Representative Bono, who is the leader on this issue in the House and her amendment is very consistent with what we are doing on the Senate side. We are trying to get the job done perhaps this year, and I appreciate her willingness to approach it in this way. I am also very happy to have my Member of Congress and my good friend Representative Baldwin here as well.

The growing prevalence of pre-dispute contractual agreements to substitute mandatory binding arbitration for the right to take a claim to court, Mr. Chairman, is very troubling to me, and I think it is worthy of this subcommittee's time and energy. I understand

that although Representative Bono's original bill is somewhat broader, as she has indicated, there is an interest in pursuing this problem initially in the area of auto dealer franchises. I have been honored to work on this with the cosponsor in the Senate, Senator Grassley of Iowa, the ranking Republican on the Senate subcommittee that is the counterpart of this House subcommittee.

S. 1020, the Motor Vehicle Franchise Contract Arbitration Fairness Act is a bill that needs to be passed this year if at all possible. I am pleased that you are considering this as a model for developing a bill here. I also want to bring to your attention, especially in light of the comments of the ranking member, Representative Nadler, that he is absolutely right. This is only one example and not the first example that I became concerned about of this problem of mandatory arbitration agreements. I have introduced two other bills in the Senate, S. 121, the Civil Rights Procedures Protection Act, and S. 2117, the Consumer Credit Fair Dispute Resolution Act. There are similar bills in the House.

These bills address the problems of mandatory binding arbitration in two other areas where such provisions have been common, employment contracts and consumer credit agreements. So in reference to Representative Nadler's remarks, I certainly believe this is all interrelated. I am just of the opinion that perhaps we can take the first step on this in the very troubling area of auto dealerships.

Let me be very clear. I absolutely believe we should encourage arbitration and mediation in cases where they can be helpful. But one of the most important pillars of our justice system is the right to take a dispute to court. Arbitration can be a credible and legitimate means of dispute resolution only when all the parties know and understand the full ramifications of agreeing to arbitration and then waive their right to go to court voluntarily.

Predispute mandatory binding arbitration provisions in contracts are particularly troubling in cases where the parties to the contracts have unequal bargaining power, because in those cases, voluntary knowing and intelligent waivers of the constitutional right are not really possible. Unequal bargaining power has been the historical theme of auto dealer franchise agreements. In most cases there is no negotiation between the manufacturer and the dealer. The dealer has to accept the terms of the agreement offered by the manufacturer or they lose their dealership. This is true even when the dealer is represented by counsel.

Over the years, dealers have relied on the States to pass laws designed to safeguard their rights against overreaching manufacturers. The first automobile franchise statute was enacted in our home State of Wisconsin in 1937 to protect Wisconsin citizens from having their dealership cancelled without cause. Since then, Mr. Chairman, all States accept Alaska have enacted statutes to safeguard auto dealers from unfair automobile and truck manufacturer practices. But unfortunately, under the Federal Arbitration Act as interpreted by the Supreme Court in the 1984 Southland case arbitrators are not required to apply the particular Federal or State law that would be applied by a court. And so that enables one party in this case, the auto and truck manufacturer, to use arbitra-

tion to circumvent laws that were specifically enacted in the States to protect the other party.

Many States have also created their own alternative dispute resolution mechanisms and forums for access to auto industry expertise that provide inexpensive, efficient, and nonjudicial resolution of disputes. For example, in Wisconsin mandatory mediation is required before the start of an administrative hearing or court action. Arbitration is also an option, as it should be if both parties agree. And these State dispute resolution forums with years of experience and precedent are greatly responsible for the small number of lawsuits between dealers and manufacturers in my State. Mandatory binding arbitration effectively renders these specific State procedures and forums null and void.

Besides losing the protection of State law and the ability to use State forums, there are numerous reasons why a dealer may not want to agree to binding arbitration. Arbitration lacks some of the important due process protections offered by administrative procedures and the judicial system, such as supervised discovery, the rules of evidence and the availability of judicial review.

Mr. Chairman, the absence of judicial review is particularly troubling to me. Mandatory binding arbitration clauses take legal disputes completely out of the realm of the legal system. I believe it is unfair to force a small business owner to put his or her livelihood at the mercy of a private justice system with no recourse to the courts whatsoever.

So in conclusion, Mr. Chairman, S. 1020 is a matter of simple fairness. Arbitration is a valid tool to save time and money that is often spent on formal legal proceedings. But no one in this country should have to give up their right to the courts in advance of a dispute arising. Ultimately I would like to see mandatory binding arbitration provisions outlawed altogether. But addressing the specific problem that has come to my attention in the auto industry is an important and worthy first step, and I certainly commend you, Mr. Chairman, for moving forward on this.

Thank you very much.

Mr. GEKAS. We thank the Senator and we turn to his colleague Senator Sessions.

STATEMENT OF HON. JEFF SESSIONS, A U.S. SENATOR FROM THE STATE OF ALABAMA

Mr. SESSIONS. Thank you, Mr. Chairman. It is an honor for me to appear before this committee and to appear before you, and we have worked on a number of important issues together, and I have such great respect for this committee and the members on it. I would just like to note that the two bills now apparently are much the same, H.R. 534 and Senate 1020, and they raise a common question about whether the Senate should undertake to eliminate the contractual requirement of binding arbitration between commercially sophisticated parties. There are many experts yet to testify, and I don't pretend to get into the dispute between the dealers and the manufacturers about their problems and how they should be settled.

Suffice it to say, I was recently contacted by Professor Stephen Ware of the Cumberland School of Law in Birmingham, Alabama,

an authority on arbitration law. He submitted a statement and I would like to place in the record to accompany my remarks. In his statement he reminds us that the promotion of contractual freedom regarding arbitration has long been a primary goal of the Federal Arbitration Act and he notes that S. 1020 would be the first Federal legislation enacted to amend that act in over 75 years.

Most of us have many automobile dealer friends, but we are here considering statutory changes that could adversely impact our legal system and even these dealers in years to come. If this Congress were for transient reasons to eliminate the binding arbitration clause in automobile dealer contracts, where would we stop?

Mr. Nadler and Senator Feingold, who I work with and respect greatly, have told you they don't want to stop anywhere. They want to eliminate all binding arbitration contracts. Behind what legal high ground could one then defend binding arbitration clauses in many other situations?

As my Judiciary Chairman Senator Hatch is want to say, it is no itty bitty matter. It is a big deal. I do not believe the Federal Arbitration Act should be severely undermined, as this bill would surely do, in order to deal with a single troubling commercial relationship. Arbitration is an established part of our legal system. People are very concerned about increasing numbers of lawsuits, increasing cost of waging these legal wars and the too often aberrational verdicts that occur.

I have no doubt that automobile dealers who advertise, who have got friends in their communities, would rather have their lawsuit tried in the home county than in an arbitration agreement because they would have more leverage there if they could file a lawsuit in their home county.

So I understand the issues involved. We need to focus, I think, on the principle involved, the overriding principle.

Passage of this bill would be a step in the wrong direction and could lead to the collapse of perhaps the single greatest act that we have in this country that contains litigation growth, binding arbitration. In my view, that position is incredibly difficult to justify. S. 1020's creation of million dollar automobile dealers, most of them have businesses that are that large, an exemption from binding arbitration clauses will stand as a precedent that will weaken the ability of anyone interested in comprehensive civil justice reform to promote arbitration as a fair, valid and cost effective method of alternative dispute resolution. If certain influential popular groups or big business groups can show they can get themselves exempted from the arbitrations application through the political process, where it will stop?

Opponents of arbitration, including the trial lawyers, are using S. 1020 as a rallying point to eliminate all arbitration clauses. I received a newsletter from a friend, Jerry Beasley, Lieutenant—former Lieutenant Governor in Alabama and a nationally recognized trial lawyer, he sends out a frankly spoken newsletter. In it recently he said, quote, it is shocking that the National Automobile Dealers Association is opposing arbitration in Congress but has pushed binding arbitration down the throats of customers of these very dealers throughout the country. He makes a valid point. Their employees and customers are often bound by arbitration.

Can we improve the arbitration system in this country? I believe so. I have been thinking about that and consideration what we might do to improve it and I expect that this committee and the Senate should begin to look at arbitration in America and see what we can do about it. But what about the dealers? Do they also benefit from the current use of contract arbitration? As Professor Ware points out—I see my time is gone. But——

Mr. GEKAS. You may proceed.

Mr. SESSIONS. The auto franchise arbitration clauses almost certainly lower the cost of becoming a franchisee. Enforcement of franchise arbitration agreements therefore is probably beneficial to the typical franchisee, and I am quoting from this letter, even if it may not be in the interest of certain franchisees, especially likely to have claims against the franchisor.

So I would submit to the committee that we should be exceedingly careful about passing legislation which would undercut a binding arbitration system as opposed to improving that system through more thoughtful reforms. And I agree with the Chamber of Commerce position and would also offer a letter from them on this subject. And I thank the Chair for his courtesy.

[The information referred to follows:]

U.S. CHAMBER OF COMMERCE,
GOVERNMENT AFFAIRS,
Washington, DC, February 28, 2000.

Hon. JEFF SESSIONS, *Senator,*
United States Senate, Washington, DC.

DEAR SENATOR SESSIONS: I am writing on behalf of the U.S. Chamber of Commerce, the world's largest business federation, representing more than three million businesses and organizations of every size. sector, and region, to express our opposition to S. 1020, the "Motor Vehicle Franchise Contract Arbitration Fairness Act."

Put simply, this legislation would have the potential of undoing arbitration clauses in every contract between motor vehicle manufacturers, importers and distributors and motor vehicle dealerships. Furthermore, this bill would undermine the Federal Arbitration Act upon which many businesses rely for the strict enforcement of agreements to engage in alternative dispute resolution and weaken clear Congressional intent to encourage alternative dispute resolution.

The Chamber believes that the parties' contractual agreements on dispute resolution should be enforceable throughout the life of the contract. Unfortunately, this bill runs counter to that principle and would allow a party to repudiate their agreement to engage in arbitration after the relationship may have soured.

S. 1020 would force many complex commercial disputes into the already crowded courts although the parties to the agreement clearly intended that arbitration be their means of dispute resolution. S. 1020 would establish a dangerous anti-contract and anti-arbitradon precedent and the U.S. Chamber urges you to oppose it.

Sincerely,

R. BRUCE JOSTEN, *Executive Vice President.*

PREPARED STATEMENT OF STEPHEN WARE, PROFESSOR, SAMFORD UNIVERSITY, CUMBERLAND SCHOOL OF LAW

I. INTRODUCTION

As a professor of law, my teaching, research and writing focus on arbitration, the subject of three bills introduced in the Senate: S. 1020—the Motor Vehicle Franchise Contract Arbitration Fairness Act, S. 121—the Civil Rights Procedures Protection Act, and S. 2117—the Consumer Credit Fair Dispute Resolution Act. I oppose these bills because they would restrict freedom of contract, raise costs to American business and probably harm the very people they purport to serve.

II. FREEDOM OF CONTRACT

The issue raised by these bills is, first and foremost, freedom of contract. The Federal Arbitration Act ("FAA") has, for 75 years, endorsed contractual freedom regarding arbitration. These bills, if enacted, would be the first federal legislation to restrict that freedom.

Under the FAA, no one is obligated to arbitrate unless he or she has agreed to arbitrate. only a contract can create the duty to arbitrate. Furthermore, the scope of that duty is determined by contract. The parties are free to agree on matters such as the process for selecting the arbitrator, the location of the arbitration, and the process for arbitration, including discovery and the taking of evidence.

This contractual freedom permits parties to customize their adjudication. Unlike courts, which basically offer only a one-size-fits-all process, arbitration offers different processes for different needs. Unlike court systems, which are government bureaucracies, arbitration is free enterprise in a competitive market. Arbitration often does a better job than courts of finding creative and innovative ways to improve adjudication procedures.

III. THE BILLS

Each of the three bills mentioned above would make arbitration agreements unenforceable in a particular context: consumer credit agreements (S. 2117), certain employment agreements (S. 121.), and automobile dealers, franchise agreements (S. 1020). These bills purport to advance the interests of consumers, employees and auto dealers. These bills would, however, likely harm most of the very people they purport to advance. I shall discuss consumers first, then employees and auto dealers.

A. Amount of Awards and Access to Justice

Assessing whether arbitration is good or bad for consumers is complicated. Simplistic opponents of arbitration assert that claims by consumers against business win more dollars from Juries than from arbitrators so arbitration must be harmful to consumers.

First, there is little, if any, reliable data on whether litigation or arbitration leads to higher awards. The answer might vary depending on the: type of claims, characteristics of parties and lawyers, region of the country, method of selecting the arbitrator and other factors.

Furthermore, any comparison of awards in litigation and arbitration would be misleading if it did not also compare settlement payments in litigation and arbitration, and dismissal before trial, as by summary judgment and motion to dismiss. There is reason to believe that claims going all the way through litigation to trial tend to be concentrated among the strongest, while those going all the way through arbitration to hearing tend to be more mixed.

Finally, any comparison of awards in litigation and arbitration would be misleading if it did not also compare the cost of pursuing a case to decision, including the cost of legal fees, the cost of discovery and the cost of delay. These costs are so high in litigation as to effectively preclude litigation of many consumer claims. The availability of fee-shifting and class actions only partially addresses this "access to justice" concern.

B. Pre-Dispute and Post-Dispute Arbitration Agreements

Those who oppose consumer arbitration often say that it is only "mandatory" arbitration they oppose. Many businesses present consumers with the take-it-or-leave-it choice of agreeing to arbitrate any disputes that might arise with that business or having no interaction at all with that business. Arbitration opponents incorrectly characterize this as "mandatory" arbitration even though the consumer has the take-it-or-leave-it choice to leave it. What opponents of so-called "mandatory" arbitration really oppose is freedom of contract. In particular, they oppose enforcement of a particular category of contract, the pre-dispute, take-it-or-leave-it arbitration agreement.

In contrast to the pre-dispute arbitration agreement, is the post-dispute arbitration agreement. If a consumer who has not previously agreed to arbitrate now has a claim against a business, that consumer and business may agree to arbitrate the particular dispute that has already arisen. These post-dispute arbitration agreements are uncontroversial. Nobody seems to mind when courts enforce them. For example, S. 2117 would continue enforcing post-dispute arbitration agreements in the consumer credit context, but not pre-dispute agreements in that context. S. 1020 and S. 121 also make this distinction between pre-dispute and post-dispute agreements.

C. Effects of Enforcing Pre-Dispute Arbitration Agreements

Those who oppose enforcement of pre-dispute arbitration agreements suggest that businesses who want to arbitrate with consumers should be limited to post-dispute agreements. When consumers form post-dispute arbitration agreements, they are likely to be advised by counsel and mentally focused on the dispute. In contrast, when they form pre-dispute arbitration agreements, they are unlikely to be advised by counsel, unlikely to be focused on the possibility of a dispute, and perhaps unaware of the existence of the arbitration clause in the contract. The argument of those who oppose enforcement of predispute arbitration agreements seems to be that if arbitration is truly beneficial to consumers, as well as to businesses, then consumers will agree to it post-dispute.

These arguments fail to address the distinction between consumers with disputes and consumers, as a whole. Even if it would typically be against a particular consumer's interests to agree to arbitration once a dispute has arisen, enforcement of pre-dispute, take-it-or-leave-it arbitration agreements is probably in the interests of consumers as a whole.

That is because arbitration almost certainly lowers prices. Arbitration reduces a business's costs, just like a technological advance or a better way of organizing an assembly line reduces a business's costs. Anything that reduces costs to business ultimately reduces the prices charged to consumers. That is Economics 101, as well as plain common sense about how competition works. And it does not rely on the assumption that consumers understand, or even read, the contracts they sign. Arbitration clauses give consumers lower prices regardless of how many consumers are aware of the arbitration clause in the contract.

For consumers as a whole, it is likely that the lower prices resulting from arbitration agreements are worth giving up the extra post-dispute leverage that may (depending on the case) come from having a right to litigate, rather than arbitrate. Post-dispute, on the other hand, the price for giving up that leverage increases dramatically because the probability of a dispute has risen from very low to certain. In other words, it is entirely rational for a consumer to prefer, at the time of contracting, that an arbitration clause be in the contract even if, at the time of a dispute, the consumer prefers that an arbitration clause not be in the contract.

To put a finer point on it, the question of take-it-or leave-it arbitration agreements may cut differently for different consumers. If you are the sort of consumer borrower who is especially likely to have a claim against your lender then you may be better off if consumer credit arbitration agreements are unenforceable (as under S. 2117). But if you are the typical consumer who is extremely unlikely to have a claim against your lender then you are probably better off with the current law enforcing these agreements and giving you lower prices (which, in the credit context, means lower interest rates).

The same reasoning applies to employees. Employment arbitration almost certainly raises the wages employees receive. Enforcement of employment arbitration agreements, therefore, is probably beneficial to the typical employee even if it may not be in the interests of-certain employees especially likely to have claims against employers.

The same reasoning applies to auto dealers. Auto franchise arbitration almost certainly lowers the cost of becoming a franchisee. Enforcement of franchise arbitration agreements, therefore, is probably beneficial to the typical franchisee even if it may not be in the interests of certain franchisees especially likely to have claims against franchisers.

IV. LEGISLATION VERSUS CASELAW

There are cases in which arbitration agreements (whether consumer, employment, franchise or anything else) should not be enforced. These include agreements induced by misrepresentation, duress, mistake, undue influence and other circumstances that, under ordinary contract law, make any contract unenforceable. The FAA already applies these ordinary contract law doctrines to arbitration agreements.

Some advocates of these three bills are concerned about arbitration agreements that are unconscionable because they require the consumer, employee or franchisee to pay excessive fees or to use arbitrators allegedly sympathetic to the opposing party. But the FAA already gives courts the tools to avoid enforcing unconscionable arbitration clauses. There is a growing body of case law clarifying which arbitration agreements are unconscionable.

These questions of ordinary contract law doctrines, including unconscionability, necessarily require a case-by-case analysis. In short, they should continue to be handled by case law made in the courts. They are not suited to the broad brush with

which legislation necessarily paints. This is an area in which the case law is evolving. Further legislation would be counter-productive.

Mr. GEKAS. Thank you. Without objection the documents to which the gentleman has referred will become a part of the record. We thank our colleagues from the Senate, and in conformity with our established custom we will not cross-examine them here. They have properly framed the issue. We can go safely into the next panel knowing that the issue has been set. Thank you.

We now convene the second panel. Our first witness is Gene Fondren, president of the Texas Automobile Dealers Association. He is a graduate of Del Mar College in Corpus Cristi, Texas and received his bachelor's degree from the University of Texas School of Business. He also received his law degree from the University of Texas. Mr. Fondren is a former three-term member of the Texas House of Representatives. He is director of the Public Television Council and of the America's Public Television Stations.

And next to him will be seated Mark Stine, director of legislative affairs of the Pennsylvania Automobile Association. Mr. Stine completed his undergraduate degree at Hampshire College in Amherst, Massachusetts before going on to receive his master's degree from the University of Pennsylvania. Prior to representing the automotive association, Mr. Stine served as senior analyst on the staff of the Pennsylvania Legislative Budget and Finance Committee. Currently Mr. Stine promotes the legislative initiatives of the national association and coordinates lobbying efforts with the Pennsylvania Congressional delegation.

Our third witness, James Hebe, is chairman, president and CEO of Freightliner. Freightliner LLC is a member of the Daimler Chrysler AG group, the world's largest commercial vehicle manufacturer. He currently serves on the boards of directors of the American Trucking Association Foundation, the U.S. Chamber of Commerce, Lycoming College and the Pacific Northwest Truck Museum. Mr. Hebe received his bachelor of science in political science and business administration from Lycoming College of Pennsylvania.

Jason Isralowitz, our next witness, is an associate at Kirkpatrick & Lockhart, LLP, which serves as outside counsel to Ferrari North America, Inc., on franchise matters. After finishing his undergraduate work at Boston University he obtained his law degree from the University of Pennsylvania Law School. Mr. Isralowitz has extensive experience in franchise disputes before arbitration tribunals as well as courts and administrative agencies.

Richard Holcomb is the commissioner of the Virginia Department of Motor Vehicles. He graduated from Hampden Sydney College and the T. C. Williams School of Law at the University of Richmond. Prior to his position at that institution, Mr. Holcomb served as chief of staff to U.S. Representatives John Linder of Georgia, D. French Slaughter, a former member from Virginia, and Craig James, the latter two who served on the House Judiciary Committee. As deputy general counsel to the Bush-Quayle reelection campaign, he provided legal advice to the President, Vice President and campaign staff members.

Florence Peterson, the next member of the panel, is general counsel for the American Arbitration Association. She graduated

from the University of Connecticut with honors before receiving her master's from the St. John's University and her law degree from Rutgers University. She has worked for the Department of Justice as a trial attorney and also as a school psychologist. Ms. Peterson has also served as senior vice president and regional vice president for the American Arbitration Association.

Jerry Turnauer is now introduced, president of Bayshore Sterling Truck in New Castle, Delaware. He received his undergraduate degree from Lafayette College in Pennsylvania and his master's from the University of Michigan. Mr. Turnauer is a member of the board of directors of the Delaware Motor Transport Association. He was elected by fellow dealers as a national Ford line representative for the American Truck Dealers.

Our final witness, James Wootton, is president of the U.S. Chamber Institute for Legal Reform. He received both his undergraduate and law degrees from the University of Virginia. Prior to working for the Chamber, Mr. Wootton served in the Reagan administration as Deputy Administrator of the Office of Juvenile Justice and Delinquency Prevention. The U.S. Chamber Institute for Legal Reform advocates reducing frivolous, wasteful and excessive litigation at both the Federal and State levels.

We will proceed in the order in which the panel was introduced, with unanimous consent for each statement already prepared to be entered as part of the record, and with each panelist accorded the privilege of speaking for about 5 minutes, and we will then submit them to some questions. We will start with Mr. Fondren.

STATEMENT OF GENE N. FONDREN, PRESIDENT, TEXAS AUTOMOBILE DEALERS ASSOCIATION, AUSTIN, TEXAS

Mr. FONDREN. Thank you, Mr. Chairman and members of the committee. I am delighted to be here today. I am President of the Texas Automobile Dealers Association, representing approximately 1400 franchise new car and truck dealers in the State of Texas. With respect to the size and wealth of automobile dealers, I would like to point out to the committee that of the 1400 that I represent in Texas, 422 of those members operate dealerships in towns of less than 15,000, 668 of those dealers are in towns of less than 50,000, and only a third of our dealers are in cities of 250,000 or more. So indeed, automobile dealerships are small businesses throughout the land and I think that in all jurisdictions you will find a similar representation of small business among dealers.

I also am here speaking on behalf of the National Automobile Dealers Association, which represents about 20,000 automobile and truck dealers across the United States, and also on behalf of the Automotive Trade Association Executives, my counterparts who operate and work for state and metropolitan associations in the country.

I am here today on behalf of these organizations to support H.R. 534, introduced by Representative Mary Bono and cosponsored by more than 180 Members of the House of Representatives. We are very grateful for that strong and broad showing of bipartisan support on behalf of H.R. 534.

H.R. 534, Mr. Chairman and members, amends the Federal Arbitration Act without, and I would like to stress if I might without,

doing violence to the principle of the spirit of the doctrine favoring arbitration as a dispute resolution mechanism. We support arbitration but what we support is voluntary arbitration.

If I might spend a moment or two, a brief history of the Federal Arbitration Act. Since its passage in 1925 there are at least four distinct histories that I think are pertinent in relation to H.R. 534. First, there is the Federal court history, which includes the United States Supreme Court, which has determined that an arbitration clause is enforceable on its face and is preemptive of State and Federal law regardless of the methodology used to obtain the arbitration agreement.

Then there is the history as defined by the American Arbitration Association, which seems to espouse the notion that an arbitration clause no matter how achieved is a very good thing. And I guess the U.S. Chamber of Commerce in its testimony will agree with that position.

Then there is the history of the motor vehicle manufacturers and motor vehicle dealers, who appear—the motor vehicle manufacturers, who appear to support arbitration as a handy device to enforce adhesive, unfair, onerous and very difficult portions of their agreement and to terminate invested dealers in a hurry if they wish to do so. So what they say about arbitration will sound very good. The truth of the matter is what dealers tell us about arbitration is not so good.

Then there is finally, and I think most importantly to this committee, the Congressional history of the Federal Arbitration Act. In 1925, the sole purpose enunciated by the Congress in adopting the Federal Arbitration Act was to require Federal courts to enforce arbitration decisions. That was the sole purpose. It was very clear from the legislative history and representations made to Members of Congress that the law would apply only to arm's-length negotiated contracts. Congress before passing the FAA was specifically assured that it would not cover take it or leave it contracts, as are the contracts that automobile and truck dealers are required to accept, contracts of adhesion like motor vehicle sales and service contracts.

Motor vehicle sales and service agreements are indeed adhesive. They are offered to dealers on a take it or leave it basis and incidentally are amendable. They can be modified and can be changed by the manufacturer at will.

I would like to say here parenthetically, if I might, Mr. Chairman and members, that Senator Sessions is incorrect in his comment that the National Automobile Dealers Association has pushed for arbitration clauses in consumer contracts. That is simply not the case. There are some of those contracts that exist in certain areas of the country, including the area from which Mr. Sessions comes, but that is not the policy or an objective of the National Automobile Dealers Association, nor is it an objective of Texas Automobile Dealers Association.

Motor vehicle sales and service contracts, which my written testimony contains a number of examples of, is inherently—they are inherently unfair. They are onerous and they are oppressive and they are inequitable. They often provide for distant venues and jurisdic-

tions far from the dealer's home base. They discriminate between dealers, and they result in an invasion of vested property rights.

Let me give you just one quick example if I might. When Chrysler Corporation acquired American Motors, it offered American Motors dealers a contract. In that contract Chrysler provided that a surviving spouse could only retain an interest in a dealership if, number 1, the dealer had so provided and so requested Chrysler before the dealer died and, number 2, if the surviving spouse in writing agreed to retain any management ability or management interest in the dealership. That is a divestment of property rights and a one-sided, adhesive contract enforceable under the Federal Arbitration Act, the kind of things that dealers are concerned about and the reason that we have had a whole body of State law in 49 States balancing and dealing with relationship between dealers and manufacturers.

[The prepared statement of Mr. Fondren follows:]

PREPARED STATEMENT OF GENE N. FONDREN, PRESIDENT, TEXAS AUTOMOBILE DEALERS ASSOCIATION, AUSTIN, TX

INTRODUCTION

Mr. Chairman and members of the committee. My name is Gene Fondren. I am the President of the Texas Automobile Dealers Association, a trade association composed of approximately 1400 franchised new automobile and truck dealers. I have held this position for more than 28 years. Prior to that, I practiced law in Taylor, Texas, served in the Texas House of Representatives and, immediately prior to assuming my current position, represented the Texas Association of Railroads and the Missouri Pacific Railroad here in Washington. I also speak for the National Automobile Dealers Association, which represents approximately 20,000 dealers, and Automotive Trade Association Executives, who represent metro and state dealer associations across the country.

I appear before you in support of H.R. 534, introduced by Representative Mary Bono and co-sponsored by more than one hundred eighty other Representatives. H.R. 534 amends the Federal Arbitration Act, but in no way does violence to the principle or the spirit of the doctrine favoring arbitration. We support alternative dispute mechanisms, including arbitration.

It is neither the intent nor the effect of the legislation to restrict or interfere with the use of *voluntary* arbitration as an alternative dispute resolution option.

HISTORICAL BACKGROUND: FEDERAL ARBITRATION ACT

In response to judicial hostility to the enforcement of arbitration agreements, the Congress in 1925 enacted the Federal Arbitration Act (FAA). In 1947, the Act was reenacted and codified as Title 9, U.S.C.[1] The stated purpose of the FAA is to ensure court enforcement of a contractual provision specifying arbitration as the means of settling a dispute. Since the issue presented by H.R. 534 involves the applicability of the FAA to contracts of *adhesion*, it may be important to briefly examine congressional intent regarding such contracts. In the *Florida Law Review,* Professor Atwood, discussing the intent of the Congress in enacting the FAA said:

> . . . courts feared that arbitration agreements could be coerced in a context of unequal bargaining power with the stronger party forcing the weaker party to relinquish the right to a judicial forum. (Atwood, *Issues in Federal-State Relations Under the Federal Arbitration Act*, 37 Fla. L. Rev. 61, 74)

In the same article, Professor Atwood also made the following cogent observation:

> The federal Act's opponents believed courts should not compel arbitration of disputes unknown to parties at the time of agreements since an individual might unwittingly sign away the right to a judicial forum for an important claim. The federal Act's legislative history does not reveal whether Congress was aware of such controversy. Nevertheless, testimony suggests some members of Congress were concerned about the related problem of the Act's applicability to adhesion

[1] 9 U.S.C. S1 *et.seq.*

contracts. When Senator Walsh of Montana voiced that during the 1923 hearing on the proposed legislation, the bill's supporters assured Congress the bill was not intended to cover insurance contracts or other "take it or leave it" arrangements. The proposed legislation, its supporters argued, simply would empower courts to enforce arbitration clauses in arms-length transactions . . . (37 Fla. L. Rev. at 75, citing the record hearings on the bill that enacted the Federal Arbitration Act.)

Congress, in its more recent enactments affecting arbitration, has shown a similar concern regarding the importance of voluntary consent and agreement in the use of arbitration. The "Administrative Dispute Resolution Act" enacted in 1990 amended Section 10 of the Act relating to the grounds for vacating an arbitration award. It is interesting to note that in §582 of the 1990 amendment, the Congress provided that "[A]n agency may use a dispute resolution proceeding for resolving an issue *if the parties agree to that proceeding*. (5 U.S.C. §582)[2] Congress articulated the same view in adopting the Judicial Improvements and Access to Justice Act.[3]

The concern expressed by Senator Walsh and the concerns implicit in recent Congressional emphasis on voluntary arbitration are, based on the interpretation given the FAA by the Supreme Court of the United States, fully justified. Judicial interpretations of the Federal Arbitration Act hold that, rather than being merely a benign tool for the management of judicial dockets, mandatory binding arbitration may be used as a hammer by which one party to a contract takes unconscionable advantage of the other. At the same time, in the case of the sales and service agreements, arbitration can circumvent an entire body of state substantive law enacted precisely to bring equity to that specific relationship.

The principle that the Act is preemptive of state law emanates from the Supreme Court's opinion in *Southland Corporation* v. *Keating*[4]. The issue in the case was the enforceability of a California statute, upheld by the California Supreme Court, regulating the relationship between franchisers and franchisees—this statute had the effect of preempting contractual arbitration clauses in favor of the regulatory structure created by the California Legislature to resolve disputes arising from a franchise relationship.

In the *Southland* case, the Chief Justice said: "[I]n creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state legislative attempts to *undercut* the enforceability of arbitration agreements." (at 861, emphasis added) It would seem that, with the quoted language, the court lays to rest the supremacy issue and the issue of whether or not the FAA's enforcement requirements are limited to actions brought in federal court (an issue made the subject of a stinging dissent).

In 1985, the Supreme Court revisited the issue in the case of *Mitsubishi Motors Corporation* v. *Soler Chrysler-Plymouth*[5], a case in which a motor vehicle dealer attempted to avoid the enforcement of a mandatory arbitration provision in its distribution agreement on the grounds that the enforcement of the arbitration clause would deprive the dealer of the ability to invoke its statutory right to bring an antitrust action under the Sherman Act. The Supreme Court was unimpressed by the argument that the vindication of substantive statutory rights should not be left to mandatory binding arbitration, even when the issues presented are complex and carry as many public policy implications as a Sherman Act claim[6]. For the court, Justice Black simply stated that "[B]y agreeing to arbitrate a statutory claim, a

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[2] P.L.101–522

[3] Although it is not amendatory of the Federal Arbitration Act, a 1988 Act of Congress (The Judicial Improvements and Access to Justice Act, 28 U.S.C. SS 651 et.seq.) also provides insight into a more recent Congressional approach to the issue of arbitration. In that law, which allows a U.S. District Court to authorize the use of arbitration in a civil action under certain circumstances, the Congress expressly provided that arbitration could not be ordered "without the parties" consent. The law further provides that such consent must be "freely and knowingly obtained."

[4] 104 S. Ct. 852 (1984).

[5] 105 S. Ct. 3346 (1985).

[6] Prior to this opinion the law on this precise issue had been established by the Court of Appeals for the Second Circuit in 1968, where the court held that, regardless of the terms of a contract, a Sherman Act claim is not subject to arbitration. *American Safety Corporation* v. *J.P. Maguire & Co.* 391 F. 2d. 821 (1968). In a well-reasoned opinion the court there provided four reasons not to compel arbitration in a Sherman Act action: the importance of private [judicial] enforcement; the possibility that a contract that results in a Sherman Act claim might be adhesive; antitrust issues are too complicated to be resolved by arbitration; and antitrust issues involve business disputes that ought not be decided by an arbitration panel of business people. As convincing as these arguments may be, however, the court in *Mitsubishi* refuted them expressly, one by one.

party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral rather than a judicial forum . . ."

Thus, the court indicates that an arbitral forum is the same as a judicial forum for the adjudication of statutory rights. Yet there is at least one major distinction: the existence of an appellate procedure to guarantee adherence to the principles of due process and other important constitutional and statutory rights. It is difficult to imagine the adjudication of substantive rights without the right to appeal but the FAA offers no effective appeal from the award of an arbitration panel. It is certainly worthy of note that, in his dissent, Justice Stevens distinguishes between simple contract claims and those arising as a result of a statutory right, stating that "[N]othing in the text of the 1925 Act, nor its legislative history, suggests that Congress intended to authorize the arbitration of any statutory claims." (Id. at 3364.) Had Justice Stevens' position been that of the court, H.R. 534 would not be necessary.

To summarize, the situation is this: the FAA, created to facilitate the enforcement of arbitration agreements, has been interpreted uniformly. It seems clear that:

1. the FAA has been construed to be preemptive of state law;
2. the FAA may be applied to require arbitration of a claim arising under a statutory right;
3. the courts are expected to enforce an arbitration clause without regard to:
   A. the complexity of the issues presented;
   B. the public policy issues presented;
   C. the existence of a comprehensive body of state statute law established for the sole purpose of adjudicating disputes arising under the contract;
   D. the fact that an arbitration panel has no authority to invoke injunctive relief; or
   E. the fact that the contract is a contract of adhesion.

With that background, let me turn to the history of the particular contractual relationship that exists between the manufacturer of a motor vehicle and its franchised dealer.

HISTORY OF CONTRACTUAL RELATIONSHIP BETWEEN MOTOR VEHICLE DEALER AND MANUFACTURER

In the preface to his book *Law and the Balance of Power* (Stewart Macauley, Russell Sage Foundation, New York, 1966) Professor Macauley has the following to say:

> For over forty years [franchised automobile dealers] have been trying to get help from the legal system to give them enforceable rights against the manufacturers which would influence the daily operation of their relationships with them. One can guess why. The 'franchise' which governed the arrangement was drafted by the manufacturer to minimize the dealer's rights, and the dealers lacked the bargaining power to gain a better contract.

It is our position that a sales and service contract between the manufacturer of a motor vehicle and its franchised dealers is not a proper one to be interpreted or enforced by arbitrators, unless the arbitration route has been chosen voluntarily by both parties *after the controversy arises*. This is so, because this contract is a classic example of a contract of adhesion. It is not negotiated. It is handed to a dealer who is expected to make, or already has made, a very substantial investment, on a "take it or leave it" basis. It is unilaterally renewed, modified or amended in the same way . . . on a "take it or leave it" basis[7]. One need impute neither malice nor avaricious intent to any party to such an agreement to note that a Chevrolet dealer in a small town does not—and can never—enjoy equal bargaining power with the largest corporation in the world.

It was this very inequity that the Congress cited in 1956 as the basis for the "Automobile Dealers" Day in Court Act."[8] In its 1956 report, the Congressional Committee made the following significant and still relevant observations:

> ". . . This vast disparity in economic power and bargaining strength has enabled the factory to determine arbitrarily the rules by which the two parties

[7] Obviously, the contractual inequity is particularly onerous in a franchise renewal or modification where the dealer already has millions of dollars invested in the dealership. At that point the dealer truly has no choice but to renew or simply accept the agreement regardless of its provisions.

[8] 15 U.S.C. § 1221–1225

conduct their business affairs. These rules are incorporated in the sales agreement or franchise which the manufacturer has prepared for the dealer's signature.

"Dealers are with few exceptions completely dependent on the manufacturer for their supply of cars. When the dealer has invested to the extent required to secure a franchise, be becomes in a real sense the economic captive of his manufacturer. The substantial investment of his own personal funds by the dealer in the business, the inability to convert easily the facilities to other uses, the dependence upon a single manufacturer for supply of automobiles, and the difficulty of obtaining a franchise from another manufacturer all contribute toward making the dealer an easy prey for domination by the factory. On the other hand, from the standpoint of the automobile manufacturer, any single dealer is expendable. The faults of the factory-dealer system are directly attributable to the superior market position of the manufacturer." S. Rep. No. 2073, 84th Congress, 2nd Sess., 2 (1956).

Although the Automobile Dealers Day in Court Act was well-intended, it has proved to be insufficient to level the playing field. The Act provides no equitable relief; it requires that a dealer prove coercion; and it fails to address the real problem inherent in this contractual relationship: the coerciveness and "one sidedness" of the sales and service agreement itself.

Thus it has fallen on the various state legislatures to provide tbe kind of equitable statutory redress necessary to protect the public and the dealer/citizens of the states and, since 1937, state legislatures have been doing just that. In Texas, for example, a broad and comprehensive public policy statement is enunciated in the statute as follows:

Section 1.02. POLICY AND PURPOSE. The distribution and sale of new motor vehicles in this State vitally affects the general economy of the State and the public interest and welfare of its citizens. It is the policy of this State and the purpose of this Act to exercise the State's police power to insure a sound system of distributing and selling new motor vehicles through licensing and regulating manufacturers, distributors, converters, and dealers of those vehicles, and enforcing this Act as to other persons, in order to provide for compliance with manufacturer's warranties, and to prevent frauds, unfair practices, discriminations, impositions, and other abuses of our citizens.

I think it is important to hear what the Supreme Court of the United States has to say about such regulatory enactments. In its seminal opinion in the case of *New Motor Vehicle Board of California* v. *Orrin W. Fox Co.*[9] the court said:

> In particular, the California Legislature was empowered to subordinate the franchise rights of automobile manufacturers to the conflicting rights of their franchisees wbere necessary to prevent unfair or oppressive trade practices. "[S]tates have power to legislate against what are found to be injurious practices in their internal commercial and business affairs, so long as their laws do not run afoul of some specific federal constitutional prohibition, or of some valid federal law . . . [T]he due process clause is [not] to be so broadly construed that the Congress and state legislatures are put in a strait jacket when they attempt to suppress business and industrial conditions which they regard as offensive to the public welfare." 439 U.S. 409, 411, citing and quoting from *Lincoln Union* v. *Northwestern Co. 335 U.S. 525, 536–537.)*

The court went on to hold that:

> Further, the California Legislature had the authority to protect the conflicting rights of the motor vehicle franchises through customary and reasonable procedural safeguards, i.e., by providing existing dealers with notice and an opportunity to be beard by an impartial tribunal—the New Motor Vehicle Board—before their franchisor is permitted to inflict upon them grievous loss. Such procedural safeguards cannot be said to deprive the franchisor of due process. States may, as California has done bere, require businesses to secure regulatory approval *before* engaging in specified practices. (439 U.S. 409, 411. Emphasis in original)

USE OF MANDATORY BINDING ARBITRATION BY MOTOR VEHICLE MANUFACTURERS AND DISTRIBUTORS

Although opponents to H.R. 534 claim that mandatory binding arbitration is little used, the facts indicate otherwise. According to a document produced by representa-

[9] 439 U.S. 96 (1978)

tives of manufacturers in November, 1999, approximately 1875 dealers are covered by mandatory binding arbitration. The document is designated on its face as a "work in progress"—as indeed it must be. None of the nation's heavy duty truck dealers are listed and there is evidence that approximately 1,000 are covered by mandatory binding arbitration.

In addition to the manufacturer's list and the truck dealers, there are others. Both Ford and General Motors impose mandatory binding arbitration in some of their dealer agreements. On November 30, 1999 Nissan notified its dealers, 1,230 in number, that mandatory binding arbitration is now the exclusive remedy for dealer manufacturer disputes involving incentives. On October 11, 1999, Volkswagen Credit, Audi Financial Services and Bentley Financial Services notified dealers that all disputes, including tort, would be resolved by binding arbitration and that the laws of the state of Michigan would govern. There are 567 Volkswagen and 258 Audi dealers.

The first major imposition of mandatory binding arbitration by a member of the "big three" occurred when Chrysler Motors Corporation acquired American Motors. Although Chrysler subsequently offered an "opt out" addendum on arbitration, the following is reflective of terms and conditions unilaterally imposed on existing dealers along with mandatory binding arbitration. At least 1,321 Daimler-Chrysler dealers are still covered by these provisions.

Following its acquisition of American Motors (AMC) in 1987, Chrysler Motors Corporation (CMC) submitted a "new" Franchise Agreement (also referred to as a sales and service agreement) to existing dealers, both AMC dealers and CMC dealers. Its directive to AMC dealers stated ". . . you will be visited by a Zone Sales Representative who will present you with a new form of Agreement for your signature. . . ."

The Chrysler Franchise (sales and service) Agreement was submitted to the dealers in two parts. The first was a basic signatory document describing the parties, products, etc. This was followed by a separate "Sales and Service" Agreement document containing "Additional Terms and Provisions"—thirty four in number—plus a Motor Vehicle Addendum.

The basic document has a global Mandatory Binding Arbitration provision which contains the following:

> *"Any and all disputes . . . including but not limited to . . . disputes under rights granted pursuant to the statutes of the state in which dealer is licensed shall be finally and completely resolved by arbitration pursuant to the arbitration laws of the United States of America as codified in Title 9 of the United States Code . . ."* (Emphasis added)

The "Additional Terms and Provisions," "Sales and Service" Agreement document, containing operative provisions covered by the mandatory binding arbitration clause, included among its more onerous provisions the following impositions:

- A requirement that the dealer maintain a rating *"equal to or greater than the average* of Customer Satisfaction Index . . . for the Sales Level Group in which dealer is included." Failure to do so would subject dealer to termination.
- Automatic termination without notice on the death of dealer in a sole proprietorship.
- Automatic termination when the manufacturer offers a new Sales and Service Agreement to all dealers of the same line make.
- A prohibition against a surviving spouse retaining a financial interest in a successor dealership unless (a) *prior to death*, dealer had delivered notice in writing naming surviving spouse as person to hold a financial interest and (b) the surviving spouse, within 60 days after death, agreed in writing not to participate in any way in the management of the dealership.
- A provision that venue and jurisdiction lay in Michigan.

All of the above-cited terms and conditions are contrary to the laws of many states, and the arbitration provision clearly was included with the intent to circumvent such state statutes. Through the utilization of an arbitration mechanism in a "take it or leave it" contract offered to existing, invested dealers, the manufacturer intended to deprive its dealers of statutory rights and remedies under state laws.

NON-NEGOTIABLE AGREEMENTS

Some opponents to H.R. 534 may argue that contracts between manufacturers and dealers are negotiated. The overwhelming evidence proves the contrary. It is

also sometimes argued that an arbitration provision has been *negotiated* with dealers. This is the claim made by factory representatives when discussing the Saturn arbitration provision.

During the formative stages of Saturn, discussions were held with a few selected General Motors dealers . . . I believe there was an initial group of five and then a second group of ten. However, these were *only prospective* Saturn dealers: General Motors dealers who likely were hoping to obtain a Saturn franchise. I am told that only two of the original five actually became Saturn dealers. Securing an understanding or agreement with a prospect who represents no one but himself is not a "negotiation" with an existing or invested automobile or truck dealer, or group of dealers.

Within the past two years, Saturn dealers in different jurisdictions attempted to enter into agreements with a third party. Saturn refused to approve the transactions, and insisted on mandatory binding arbitration to resolve the dispute. After attempting to exercise their rights and remedies under state laws and administration procedures which would have possibly allowed them to proceed with plans, and after a very considerable amount of time and expense, the dealers finally capitulated and sold their dealerships to Saturn.

You may well ask why these dealers did not take their chances with Saturn arbitration. A look at the Saturn arbitration scheme provides an answer. The Saturn arbitration plan has a panel of four arbiters—two employees of Saturn and two Saturn dealers chosen from a pre-selected list. Sounds reasonably fair except—Saturn picks all four and all four must reach a unanimous decision to achieve an outcome. If a unanimous decision is not reached, the parties must re-arbitrate their dispute before a different Saturn arbitration panel, picked by Saturn. Although it seems obvious that this creates opportunity for inherent "bias," a court has rejected any such notion.

Again, on the issue of negotiation and on the point of convenience and expense of arbitration, the Sterling Truck saga offers telling insight. Freightliner, a subsidiary of Daimler-Chrysler, purchased HN–80 and cargo product lines from Ford Motor Company. In its notice to existing Ford dealers and its offer of a franchise agreement, HN–80 Corporation (now Sterling) included mandatory binding arbitration of all disputes and added a requirement that the dealer personally guarantee payment for all purchases, including vehicles, from the manufacturer.

Because there was a substantial number of dealers involved (rather than the typical case where there is a manufacturer v. one dealer) a proposal that the manufacturer perceived to be a compromise was offered. In lieu of the personal guarantee, "it was agreed that invoicing and payment terms for new trucks will be the day trucks are ready for delivery to the transporter (Day 1)." Apparently, instead of guaranteeing payment, the dealers pay in advance of delivery.

On the issue of mandatory binding arbitration the manufacturer provided: "Binding arbitration will be required of all qualified current Ford HN–80 dealers . . . for three years. Any HN–80 dealer signed with this provision will be offered an "Opt Out" after the three year period, *providing that the dealership is meeting all HN–80 requirements and is not on termination notice."* (Emphasis added) All other/subsequent HN–80 dealers signed will be bound by Binding Arbitration and will not be offered an "Opt Out." As anyone with any experience in the industry knows it is virtually impossible for a dealer to meet "all requirements" of the factory. So there is a serious question as to whether there will really be an "Opt Out" for any Sterling dealers. The manufacturer clearly controls that final decision.

Recently an issue has risen between Sterling and a number of its dealers regarding a medium duty truck called the *Acterra*. Sterling insists that it is a new linemake and is attempting to require dealers to sign a separate agreement and meet certain other criteria. Dealers maintain that it is merely a new model covered by the existing franchise agreement.

Knowing that their agreements require mandatory binding arbitration, approximately forty Sterling dealers filed for consolidated arbitration in Cleveland, Ohio, the situs of Sterling's home office. Sterling objects and argues: "Because the arbitration agreements between the claimants do not contain a provision for consolidating arbitration, Sterling cannot be forced to proceed with the consolidated arbitration . . ." Counsel for the dealers responds: "Having once touted binding arbitration as 'the most expeditious and least costly method of resolving disputes,' Sterling now seeks to undermine the essential advantage of arbitration, as advertised *by it* and compel the resolution of more than forty virtually identical claims in at least twenty different venues." Sterling, in its pleadings, also complains that the dealers "paid only a single filing fee" for arbitration. Although the American Arbitration Association (AAA) is apparently satisfied, Sterling insists on a separate fee from each dealer.

The extent to which manufacturers will overreach the dealer on this issue is illustrated in both Ford Motor Company's *Stock Redemption Plan/Dealer Development Agreement* and in General Motor's *Motors Holding Investment Plan.* These are the agreements Ford and General Motors offer in dealer development programs, principally with minority dealers.

In the Ford *Dealer Development Agreement* we find the following:

> "If appeal to the Policy Board fails to resolve any dispute covered by this Article 10 within 180 days after it was submitted to the Policy Board, the dispute shall be finally settled by arbitration in accordance with the rules of the CPR Institute for Dispute Resolution (the "CPR") for Non-Administered Arbitration for Business Disputes, by a sole arbitrator, but no arbitration proceeding may consider a matter designated by this Agreement to be within the sole discretion of one party (including without limitation, a decision by such party to make an additional investment in or loan or contribution to the Dealer), and the arbitration proceeding may not revoke or revise any provisions of this Agreement. Arbitration shall be the sole and exclusive remedy between the parties with respect to any dispute, protest, controversy or claim arising out of or relating to this Agreement."

In the General Motors *Investment Plan* the dealer, referred to as the Operator, is required to agree to the following provision:

> "The Operator will not be allowed to bring a lawsuit against General Motors for claims arising before and during the time Motors Holding is an investor in the Dealer Company. Instead, the Operator, General Motors and the Dealer Company agree to submit any and all unresolved claims, including those pertaining to any dealer sales & service agreement, to mandatory and binding arbitration. The results of the arbitration will be binding on the Operator, the Dealer Company and General Motors."

Nissan, in its recent *Revised Incentive Program Rules*, provides for mandatory Binding Arbitration and attempts to foreclose any remedies otherwise available to dealer under state or federal law.

> "By receiving incentive payments, Dealer agrees to resolve disputes involving incentives payments by this Dispute Resolution Process. Furthermore, Dealer acknowledges that at the state and federal level, various courts and agencies would, in the absence of the agreement, be available to them to resolve claims or controversies which might arise between NNA and Dealer (NNA and Dealer collectively referred to as "Parties"). The Parties agree that it is inconsistent with their relationship for either to use courts or governmental agencies to resolve such claims or controversies.

In its October 11, 1999 notice to its dealers, Volkswagen Credit imposes Mandatory Binding Arbitration with the following language:

> "The parties will attempt first to resolve each and every dispute or claim, whether based in contract, tort, statute, fraud, misrepresentation or any other legal theory, whether pre-existing, present or future arising out of or relating to this Agreement ("Dispute") through good faith negotiations. Any Dispute that is not resolved within 180 days, or any other period of time that the parties may agree in writing, will be settled by final and binding arbitration by either party making a demand to the other for arbitration of the Dispute. Such demand must be made pursuant to the filing procedures of the American Arbitration Association ("AAA") for the arbitration of commercial disputes."

DISPARATE BARGAINING POWER

It has been suggested by opponents that H.R. 534 is unnecessary because there is no longer disparate bargaining power between manufacturers and dealers—and cite for you the existence of large publicly-held dealer companies, mega-dealers etc. There are, of course, a few of these. But it is the vast majority of independent dealers who need the relief granted by the passage of S. 1020.

Texas is a fairly populous state with approximately eighteen million people. Many other jurisdictions represented here today are far less populous, but I believe that the Texas numbers will be helpful in revealing the relative size and resources of the dealer body. In Texas, we have a count of about 1500 franchised dealers. Of these, 184 are in towns of fewer than 5,000; 238 in towns of 5,000 to 15,000; 246 in towns of 15,000 to 50,000; 294 in towns of 50,000 to 250,000; and 352 in cities of 250,000 plus. The vast majority of dealers reside and do business in the small

and medium size towns. These are not mega-dealers, but rather are small, sole proprietor or family-owned businesses.

Are these dealers in these small and medium sized cities important? They're important to their employees and the communities they serve—and they should be important to the manufacturers. In 1996, 23% of the vehicles sold by General Motors in Texas were sold in towns of not more than 15,000 population. If you add the towns of not more than 50,000 population, it's 41%.

These dealers, many of whom have received "stay-with-you" letters from their manufacturers, represent the vast majority of the dealers across the nation affected by H.R. 534. The so-called "stay-with-you" letters told the dealer that he or she could continue to operate the dealership, but that in the event of the dealer's death or attempt to sell the dealership, it (the dealership) would be declared non-viable.

SUMMARY

From the foregoing, the following may be concluded:

1. the sales and service agreement that exists between a motor vehicle manufacturer, importer, or distributor and its franchise dealers is not a negotiated agreement; it is a classic contract of adhesion, presented to the dealer on a "take it or leave it" basis;
2. historically and currently, the agreement offered by a manufacturer, importer, or distributor of motor vehicles to its franchised dealers is inherently unfair and inequitable;
3. every state except one has a regulatory scheme in place to bring equity to this inherently inequitable relationship;
4. an arbitration clause in a contract is enforceable on its face, regardless of the existence of state law or regulation to the contrary;
5. although an arbitration panel may attempt to understand and enforce the terms of a state regulatory scheme, nothing requires it to do so, it has no ability to enter injunctive relief, and there is no appeal if the panel misapplies or ignores state or federal law; and
6. by placing an arbitration clause in this "take it or leave it" contract, the stronger party may impose mandatory binding arbitration on an unwitting or unwilling dealer and circumvent state and federal law designed specifically to regulate the relationship that is the subject of the agreement.

Thus is the problem. H.R. 534 addresses the problem in a straightforward and simple way. Under the terms of H.R. 534, an arbitration clause may properly be included in Sales and Service Contract. However, the potential for abuse of such a clause in a non-negotiated contract has been eliminated by Subsection (b) of the new Section 17 that H.R. 534 would add to the Federal Arbitration Act. That provision expressly provides that, "Whenever a sales and service contract provides for the use of arbitration to resolve a controversy arising out of or relating to the contract, each party to the contract shall have the option, after the controversy arises and before both parties commence an arbitration proceeding, to reject arbitration as the means of settling the controversy. Any such rejection shall be in writing."

Thus, H.R. 534 will remove the potential of these contracts to deprive persons of statutory rights and remedies without doing violence to the public policy interest served in encouraging arbitration as a means of dispute resolution. H.R. 534 simply makes arbitration voluntary. It solves the problems it addresses.

Mr. GEKAS. We thank the gentleman, and we turn to Mr. Stine for 5 minutes.

STATEMENT OF MARK K. STINE, DIRECTOR OF LEGISLATIVE AFFAIRS, PENNSYLVANIA AUTOMOBILE ASSOCIATION, HARRISBURG, PA

Mr. STINE. Thank you, Mr. Chairman. Good morning, members of the subcommittee. My name is Mark Stine, and I am here today representing the Pennsylvania Automotive Association, who I serve as the Director of Legislative Affairs. Our association, which represents the 1300 new motor vehicle dealers and their 60,000 dealership employees, strongly supports H.R. 534, the Fairness and Voluntary Arbitration Act, and urges its quick passage to ensure

that Pennsylvania's procedural and substantive law will be available to manufacturer-dealer disputes.

Automobile and truck manufacturers are presently attempting to circumvent State laws, including Pennsylvania's law, by including mandatory and binding arbitration in dealer agreements as the sole dispute resolution mechanism for dealers. The manufacturers are using the Federal Arbitration Act to force dealers into mandatory and binding arbitration in their non-negotiated franchise contracts. Unless changes are made to this Federal statute, automobile and truck manufacturers will continue to have the ability to unilaterally impose mandatory and binding arbitration on dealers and deny them the opportunity to resolve disputes under the State laws designed to govern the relationship between manufacturers and dealers. H.R. 534 would rectify the situation by giving the parties to a motor vehicle franchise contract the opportunity to voluntarily choose arbitration as a means of settling a dispute rather than having it forced upon them in a take it or leave it contract.

The Pennsylvania legislature, like 48 other States, has enacted a comprehensive body of State law that regulates the relationship between manufacturers and dealers and provides specific remedies. This body of law provides a comprehensive structure whose only purpose is to regulate the relations between and among consumers, dealers, and motor vehicle manufacturers. Pennsylvania has adopted their motor vehicle franchise law to respond to the onerous, oppressive and unfair burdens often imposed by manufacturers in their non-negotiated franchise agreements. These statutes address such issues as prohibiting a manufacturer from terminating a dealer without just cause, protecting the rights of spouses and children to continue ownership after a dealer's death and preventing a manufacturer from placing unreasonable conditions and requirements on a dealer.

The Pennsylvania legislature has essentially determined that public policy favoring comprehensive regulation of the industry is more important than upholding specific provisions of a non-negotiated franchise agreement. The Pennsylvania motor vehicle franchise law overrides any agreement to the extent it is inconsistent with State law.

In Pennsylvania, as is the case in most States, we also have in place an efficient and economical alternative to a dispute resolution system outside the traditional court system for such important cases as termination, establishment of new dealerships and relocation of motor vehicle dealers. The process followed by the Pennsylvania State Board of Vehicle Manufacturers, Dealers and Sales Persons, which is made up of government, public and industry representatives, demonstrates both the benefits of the Pennsylvania process and the limitations of arbitration in resolving manufacturer-dealer disputes.

For example, discovery is generally available to the dealer in cases before the board. In arbitration, discovery is either not permitted or limited. This lack of discovery almost always puts the dealer at a distinct disadvantage.

In contrast to the supposed benefits of arbitration in terms of cost and expediency, the Pennsylvania board process can be more expedient and less costly. In Pennsylvania the Motor Vehicle Board

must render a decision within 120 days. In arbitration, costs are often higher since parties must fund the arbitration process, including compensation for the arbitration panel's hearing time and expenses. These costs, along with pursuing the arbitration in a distant forum that some manufacturers require, become a tremendous disincentive for dealers to protest manufacturers' actions. Equally troublesome is the fact that most manufacturer-dealer agreements include a provision that attempts to apply the law of another State if conflicts arise. For example, the contracts often state that the law of Ohio, Michigan or New York shall apply even if the dealer's business is located in Pennsylvania. This effort to circumvent State law is not successful under Pennsylvania law when a State board or court adjudicates the dispute.

Perhaps the most striking feature of mandatory and binding arbitration is the fact that arbitrators are not required to follow State law or precedent and no remedy is available if the law is misapplied. In contrast, the Pennsylvania board process is a public proceeding requiring a written and factual basis for the opinion that can be appealed to ensure that precedent has been respected. Under arbitration, the conclusions are not even published and the decision is final, absent fraud or collusion.

To illustrate the impact of mandatory binding arbitration on dealers, I would like to give the committee a real life example. In this case, a Pennsylvania truck dealer who sought to contest the manufacturer's action before our board was forced into arbitration. He reported that while the arbitration process was expeditious, the arbitration was costly, the arbitrator did not understand and apply State law, the arbitration was in an inconvenient location, and finally that the decision was unfair with no opportunity to appeal. This case is not unique and points out the pitfalls of arbitration. While arbitration can be expeditious, it does not necessarily translate into a fair process. In this case, the dealer's rights under Pennsylvania law were sacrificed for an expeditious hearing which he would have gotten under our board at less expense and with better legal safeguards. By placing mandatory binding arbitration in this take it or leave it contract, which the manufacturer has the power to do at any time, I think anyone can see that arbitration is being used in that circumstance as more than a benign tool to manage judicial dockets. It is being used as a hammer by which one party takes unconscionable advantage over the other. Yet the effect of the Federal Arbitration Act, as currently interpreted by the Supreme Court, upholds these arbitration clauses, allowing the manufacturer to circumvent statutory rights as if they do not even exist.

Mr. GEKAS. The gentleman's time has expired. Even though it shows green, believe me it has expired.

Mr. STINE. Thank you.

[The prepared statement of Mr. Stine follows:]

PREPARED STATEMENT OF MARK K. STINE, DIRECTOR OF LEGISLATIVE AFFAIRS, PENNSYLVANIA AUTOMOBILE ASSOCIATION, HARRISBURG, PA

SUMMARY

The Pennsylvania Automotive Association strongly supports H.R. 534, introduced by Representative Bono and cosponsored by 180 other Members, and urges its passage to ensure that Pennsylvania's procedural and substantive law will be available in motor vehicle manufacturer/dealer disputes. If the Federal Arbitration Act (FAA)

is not amended as H.R. 534 provides, manufacturers will continue to use the FAA and mandatory binding arbitration to skirt state laws that regulate and balance the relationship between manufacturers and dealers.

By making arbitration a voluntary choice rather than having it forced upon them by the manufacturer in a contract of adhesion, under H.R. 534 automobile and truck dealers will have a choice to utilize their state remedies or voluntarily agree to arbitration. Motor vehicle franchise laws in 49 states provide these remedies to protect dealers from coercive requirements and practices imposed by the manufacturer's non-negotiated franchise agreements. State motor vehicle franchise laws override such agreements when inconsistent with state law.

Pennsylvania law already provides for an alternative dispute resolution forum for manufacturer/dealer disputes involving such important issues as termination, establishment, and relocation of motor vehicle franchises. Mandatory and binding arbitration denies dealers access to this forum. Not only is the process before the Pennsylvania State Board expeditious and economical, it also provides important legal safeguards by ensuring that the law of Pennsylvania is applied, precedent is followed, and any misapplication of law can be remedied. None of these safeguards are present in mandatory and binding arbitration.

Yet, the effect of the Federal Arbitration Act, as currently interpreted by the Supreme Court, upholds mandatory and binding arbitration clauses inserted unilaterally by the manufacturer, allowing the manufacturer to circumvent state statutory rights as if they do not exist. Congressional action is necessary to restore fundamental rights of fairness. By adopting H.R. 534 and making arbitration voluntary in motor vehicle manufacturer/dealer disputes, Congress can restore the rights conferred by state legislatures throughout the country and prevent their denial by the unilateral action of the manufacturers.

STATEMENT

Mr. Chairman and Members of the Subcommittee, my name is Mark Stine and I am here today representing the Pennsylvania Automotive Association where I serve as the Director of Legislative Affairs. Our association, which represents more than 1300 new motor vehicle dealers and their 60,000 dealership employees, strongly supports H.R. 534, the Fairness and Voluntary Arbitration Act, and urges its quick passage to ensure that Pennsylvania's procedural and substantive law will be available in manufacturer/dealer disputes. Automobile and truck manufacturers are presently attempting to circumvent state laws, including Pennsylvania;s law, by including mandatory and binding arbitration in dealer agreements as the sole dispute resolution mechanism for dealers. Mandatory and binding arbitration greatly compromises state rights.

The manufacturers are using the auspices of the Federal Arbitration Act to skirt state law. Unless changes are made to this federal statute, automobile and truck manufacturers will continue to have the ability to unilaterally impose mandatory and binding arbitration on dealers and deny them the opportunity to resolve disputes under the state laws designed to govern the relationship between manufacturers and dealers. H.R. 534 would rectify this situation by giving the parties to a motor vehicle franchise contract the opportunity to voluntarily choose arbitration as a means of settling a dispute rather than having it forced upon them in a "take it or leave it" contract.

The Pennsylvania Legislature, like 48 other states, has enacted a comprehensive body of state law that regulates the relationship between manufacturers and dealers and provides specific remedies. This body of law provides a comprehensive structure whose only purpose is to regulate the relations between and among consumers, dealers, and motor vehicle manufacturers. Based on decades of experience, the states have deemed these laws necessary to address the coerciveness of the franchise agreement itself. These so-called "agreements" are contracts of adhesion drafted unilaterally by the manufacturer. Inevitably and invariably they minimize dealer rights and remedies.

Pennsylvania has adopted their motor vehicle franchise law to respond to the onerous, oppressive, and unfair burdens imposed by manufacturers in their franchise agreements. These statutes address such issues as prohibiting a manufacturer from terminating a dealer without just cause, protecting the rights of spouses and children to continue ownership after a dealer's death, and preventing a manufacturer from placing unreasonable conditions and requirements on a dealer. The Pennsylvania Legislature has essentially determined that public policy favoring comprehensive regulation of the industry is more important than upholding specific provisions of a non-negotiated franchise agreement. The Pennsylvania motor vehicle franchise law overrides any agreement to the extent it is inconsistent with state law.

In Pennsylvania, as in the majority of states, a state agency is charged with administering and enforcing the law. As is the case in most states, we also have in place an efficient and economical alternative dispute resolution system outside the traditional court system for such important cases as termination, establishment of new dealerships, and relocation of motor vehicle dealers. The process followed by the Pennsylvania State Board of Vehicle Manufacturers, Dealers and Salespersons, which is made up of government, public, and industry representatives, demonstrates both the benefits of the Pennsylvania process and the limitations of arbitration in resolving manufacturer/dealer disputes.

For example, discovery is generally available to the dealer in cases before the board. Discovery is particularly important in vehicle manufacturer/dealer disputes because the manufacturer has access to significantly more data that the dealer will be unable to procure from third party sources. In arbitration, discovery is either not permitted or limited. This lack of discovery almost always puts the dealer at a distinct disadvantage.

In contrast to the supposed benefits of arbitration in terms of cost and expediency, the Pennsylvania board process can be more expedient and less costly. In Pennsylvania, the motor vehicle board must render a decision within 120 days. In terms of cost, there are typically no cost savings in commercial arbitration. In fact, costs are often higher in arbitration since parties must fund the arbitration process, including compensation for the arbitration panel's hearing time and expenses. Additionally, the arbitration clause may mandate the award of attorneys' fees and costs to the prevailing party, forcing the cost and expense on the non-prevailing party. These costs, along with pursuing the arbitration in a distant forum that some manufacturers require, become a tremendous disincentive for dealers to protest manufacturers' actions.

Equally troublesome is the fact that most manufacturer/dealer agreements include a provision that attempts to apply the law of another state if conflicts arise. For example, the contracts often state that the law of Ohio, Michigan or New York shall apply even if the dealer's business is located in Pennsylvania. This effort to circumvent state law is not successful under Pennsylvania law when a state board or court adjudicates the dispute. The board or court will apply the law of Pennsylvania. However, if an arbitrator hears the case, in all likelihood he or she will apply the law of whatever state is provided for in the contract, if it applies any law at all, and Pennsylvania's law is effectively circumvented.

Perhaps the most striking feature of mandatory and binding arbitration is the fact that arbitrators are not required to follow state law or precedent and no remedy is available if the law is misapplied. In contrast, the Pennsylvania board process is a public proceeding requiring a written and factual basis for the opinion that can be appealed to ensure that precedent has been respected. Under arbitration, the conclusions are not published, arbitrators do not rely on precedent, and the decision is final, absent fraud or collusion. Dealers have no way to predict what procedure will be used, what facts will be considered, or what standard the arbitrator will use to determine the outcome of the case. Additionally, this lack of precedent for future disputes actually stifles development of the law and results in more manufacturer/dealer disputes.

To illustrate the impact of mandatory binding arbitration on dealers, I'd like to give the committee a real life example. In this case, a Pennsylvania truck dealer who sought to contest a manufacturer's action before our board was forced into arbitration. He reported that while the arbitration process was expeditious, the arbitration was costly, the arbitrator did not understand and apply state law, the arbitration was in an inconvenient location, and finally that the decision was unfair with no opportunity to appeal. This case is not unique, and points out the pitfalls of arbitration. While arbitration can be expeditious, it does not necessarily translate into a fair process. In this case, the dealer's rights under Pennsylvania law were sacrificed for an expeditious hearing, which he would have gotten under our board at less expense with better legal safeguards.

By placing mandatory and binding arbitration in this "take it or leave it" contract, which the manufacturer has the power to do at any time, I think anyone can see that arbitration is being used in this circumstance as more than a benign tool to manage judicial dockets. It is being used as a hammer by which one party takes unconscionable advantage of the other. Yet, the effect of the Federal Arbitration Act, as currently interpreted by the Supreme Court, upholds these arbitration clauses, allowing the manufacturer to circumvent statutory rights as if they do not exist.

Mr. Chairman and Members of the Subcommittee, the automobile and truck dealers of your states would not be here today seeking relief if there were any other alternative. Because the Supreme Court ruled that the Federal Arbitration Act preempts state law and even applies in contracts of adhesion like this one, Congress

must amend the Federal Arbitration Act to make sure that arbitration is voluntary and not used by the manufacturer to circumvent substantive state law that governs this relationship. Your action is necessary to restore fundamental rights of fairness, which were conferred by state legislatures and are being denied by the unilateral decisions of the manufacturers.

Mr. GEKAS. We now turn to Mr. Hebe. But before we start the Chair is obligated to testify at another subcommittee hearing that is currently in session and so we will yield the gavel to the lady from California until the return of the Chair to his accustomed place.

Mr. Hebe may proceed.

STATEMENT OF JAMES HEBE, CHAIRMAN, PRESIDENT AND CEO, FREIGHTLINER LLC, PORTLAND, OR

Mr. HEBE. Good morning, Mr. Chairman, members of the subcommittee. My name is Jim Hebe. I am the President and Chief Executive Officer of Freightliner Corporation, and I truly appreciate the opportunity to testify before your subcommittee on H.R. 534. Our company is the largest manufacturer of heavy and medium duty trucks in North America. Freightliner produces in markets class 3 through 8 vehicles under the Freightliner Sterling, American LaFrance and Thomas Built Buses nameplates and is a DaimlerChrysler company, the world's leading commercial vehicle manufacturer.

Freightliner strongly opposes H.R. 534, the Fairness and Voluntary Arbitration Act. Freightliner has a long and successful history of using binding arbitration as a dispute resolution mechanism in its dealer agreements. We find it appalling that the automobile dealers in a seemingly hysterical reaction to a problem that does not exist are attempting to obtain a special exemption to the Federal Arbitration Act that no other group enjoys and interfere with the long-standing and successful contractual relationship Freightliner has with its dealers.

Parenthetically, the truth of the matter is that in 12 years of using arbitration we have had three cases that have gone to arbitration when we have not won every one. Freightliner, although smaller than most of the major automobile manufacturers, has used arbitration in its dealer agreements more extensively than perhaps any other company. We elected to begin including arbitration in our agreements in the late 1980's in an attempt to find a fairer, a faster and more economical way to resolve disputes with our dealers. Prior to our decision to begin including arbitration in our agreements we had found that the two most commonly used dispute resolution forums were entirely unsatisfactory. State dealer boards often have an anti-manufacturer bias and the rule is almost always the dealer wins. On the other hand, the judicial process is extremely slow, it is extremely expensive and usually results in complex cases being decided by a relatively unsophisticated fact finder with often arbitrary outcomes.

Our experience with arbitration, on the other hand, has been quite positive both for Freightliner and the dealer litigant. The dealer enjoys the benefits of the substantive provisions of the State law in which he or she is located and both sides gets the benefit of a relatively fast, economically achieved decision by a highly experienced commercial arbitrator that is chosen by the parties.

The unique demands of our business require us to find a more flexible approach for dealing with problem dealers. While many of the car manufacturers have a national network of 5000 or more dealers, Freightliner has only about 600 dealer points nationwide. Accordingly, we and our customers rely much more heavily on each dealer. In some States one dealer is responsible for providing the new truck sales parts and service for the entire State. When such a dealer's performance falls below standards and can't be fixed, Freightliner and its customers suffer until the dealer can be replaced. We often don't have the luxury of referring our customers to another dealer where our protracted legal dispute is played out, since in many cases there just is no other nearby dealer.

At Freightliner dealership agreements containing arbitration are offered at the inception of the relationship. When we first began using arbitration, all of our then existing dealers were given the option to opt out of arbitration. Some chose arbitration, others did not. Since that time all new dealers have agreed to accept arbitration in their agreements as they chose to become Freightliner dealers. Those individuals have voluntarily entered into that contractual relationship with us, fully understanding that arbitration was part of the equation.

It has been our experience that these sophisticated businesspeople fully understand the company's need to have arbitration and that rarely, if ever, have any prospective dealer candidates questioned its use.

In closing, let me say that our experience with arbitration has worked extraordinarily well. It is used in the wide array of businesses. It allows essentially private disputes to be privately decided at no public expense. Contrary to a long-standing Federal policy favoring arbitrary dispute resolution, H.R. 534 would significantly weaken the entire concept of arbitration and would do so for a benefit of a group that does not need Federal intervention to further protect itself.

Dealers already enjoy the benefits of extremely protective State laws. This special exemption is even more outrageous given the fact that there is absolutely no record of an abuse of binding arbitration in dealer agreements. Automobile and truck dealers today already enjoy special legislative protection at the Federal and State level that far exceeds that granted to virtually any other business. H.R. 534 only further extends that unwarranted exception.

Additionally, hardly any other business group I can imagine is more challenged by its customers to improve its performance and its business practices than our automobile dealers. Every customer satisfaction survey and our own personal experiences bear that out. H.R. 534 only serves to thwart the action of responsible manufacturers, respond to our customers' justified requests. This body should not enact legislation that interferes with or encumbers that process. Thank you.

[The prepared statement of Mr. Hebe follows:]

PREPARED STATEMENT OF JAMES HEBE, CHAIRMAN, PRESIDENT AND CEO, FREIGHTLINER LLC, PORTLAND, OR

Good morning Mr. Chairman and Members of the Subcommittee. My name is James L. Hebe. I am the President and Chief Executive Officer of Freightliner LLC and truly appreciate the opportunity to testify before your Subcommittee on H.R.

534. Our company is the country's leading manufacturer of heavy and medium duty trucks in North America. Freightliner produces and markets Class 3–8 vehicles under the Freightliner, Sterling, American LaFrance and Thomas Built Buses nameplates and is a DaimlerChrysler company, the world's leading commercial vehicle manufacturer.

Freightliner strongly opposes H.R. 534, The Fairness and Voluntary Arbitration Act. Freightliner has a long and successful history of using binding arbitration as the dispute resolution mechanism in its dealer agreements. We find it appalling that automobile dealers, in a seemingly hysterical reaction to a "problem" that does not exist, are attempting to obtain a special exemption to the Federal Arbitration Act that no other group enjoys, and interfere with the longstanding and successful contractual relationship Freightliner has with its dealers.

Freightliner, although smaller than most of the major automobile manufacturers, has used arbitration in its dealer agreements more extensively than perhaps any other company. We elected to begin including arbitration in our agreements in the late 1980s in an attempt to find a fairer, faster, and more economical way to resolve disputes with our dealers. Prior to our decision to begin including arbitration in our agreements, we had found that the two most commonly used dispute resolution forums were entirely unsatisfactory. *State dealer boards* often have an anti-manufacturer bias and the rule is almost always "the dealer wins." On the other hand, *the judicial process* is extremely slow, extremely expensive, and usually results in complex cases being decided by relatively unsophisticated fact finders with often arbitrary outcomes.

Our experience with arbitration, on the other hand, has been quite positive both for Freightliner and the dealer litigant. The dealer enjoys the benefits of the *substantive provisions* of the state law in which he or she is located, and both sides get the benefit of a relatively fast, economically achieved decision by a highly experienced commercial arbitrator *chosen by the parties*.

The unique demands of our business require us to find a more flexible approach for dealing with problem dealers. While many of the car manufacturers have a national network of 5,000 or more dealers, Freightliner has only about 600 dealer points nationwide. Accordingly, we and our customers rely much more heavily on each dealer. *In some states, one dealer is responsible for providing the new truck sales, parts, and service for the entire state.* When such a dealer's performance falls below standards, and can't be fixed, Freightliner and its customers suffer until the dealer can be replaced. We often don't have the luxury of referring our customers to another dealer while a protracted legal dispute is played out, since in many cases *there is no other nearby dealer.*

At Freightliner, dealership agreements containing arbitration are offered at the *inception of the relationship.* When we first began using binding arbitration all of our then existing dealers were given the option to "opt out" of arbitration. Some chose arbitration, many others did not. Since that time, all new dealers have been required to accept arbitration if they wished to become a Freightliner dealer. Those individuals have voluntarily entered into the contractual relationship with us fully understanding that arbitration was part of the equation. It has been our experience that these sophisticated business people fully understand the company's need to have arbitration, and that rarely, if ever, have any prospective dealer candidates questioned its use.

In closing, Mr. Chairman, let me say that our experience with arbitration has worked extraordinarily well. It's used in a wide array of businesses. It allows essentially private disputes to be privately decided at no public expense. Contrary to a longstanding federal policy favoring alternative dispute resolution H.R. 534 would significantly weaken the entire concept of arbitration, and would do so for the benefit of a group that does not need federal intervention to further protect itself. Dealers already enjoy the benefit of extremely protective state laws. *This special exemption is even more outrageous given the fact that there is absolutely no record of any abuse of binding arbitration in dealer agreements.* Thank you.

Mrs. BONO. [Presiding.] Thank you. I will note to the other panelists that the lights are not apparently working, so if you can keep a eye on it or sort of self-time it. That was very close actually.

Mr. Isralowitz.

STATEMENT OF JASON P. ISRALOWITZ, KIRKPATRICK & LOCKHART, LLP, NEW YORK, NY

Mr. ISRALOWITZ. Good morning. My name is Jason Isralowitz, and I am an attorney with Kirkpatrick & Lockhart, which serves as outside counsel for Ferrari North America on franchise matters. Ferrari is the exclusive authorized distributor of new vehicles parts and accessories in the United States. Thank you for inviting me to testify on Ferrari's behalf concerning the proposed Fairness and Voluntary Arbitration Act.

Ferrari strongly opposes this bill because it would prevent the company from continuing to include mandatory arbitration as a term of its standard franchise agreement. Our experience has been that arbitration affords dealers and manufacturers alike a fair and efficient means of resolving their disputes.

The Ferrari dealer agreement provides that any and all disputes arising out of or in connection with the agreement shall be submitted to arbitration before the American Arbitration Association in New York. This provision has been consistently sustained by Federal courts as a valid and enforceable agreement subject to the Federal Arbitration Act.

In accordance with the agreement, Ferrari has arbitrated a significant number of matters with its dealers. The procedures used in these cases dispel a number of the claims being advanced in support of H.R. 534.

To begin with, the arbitrators presiding over Ferrari's franchise matters have been independent and extremely well-qualified. Appointments are made from a pool that includes former State and Federal court judges, former government officials and experienced commercial litigators.

By way of example, one recent panel was comprised of two former Federal district judges with a collective 28 years of experience between them, along with former U.S. Attorney General Nicholas Katzenbach. This is hardly the type of tribunal prone to acting in disregard of the law. Other Ferrari arbitrators have included a former judge of the U.S. Court of Appeals for the Third Circuit and a former New York State Supreme Court judge.

The caliber of these jurists is especially significant because both parties have input into the selection of the arbitrator. The Arbitration Association permits both parties to rank potential arbitrators in order of preference and to strike from the list any individuals they find objectionable. As a result, a Ferrari dealer has far more input into the identity of the individual decisionmakers are words makers in arbitration than most litigants have in court or before administrative agencies.

Once appointed, the arbitrator has the power to direct the exchange of relevant documents prior to the hearing. The availability of document discovery dispels the claim that arbitration is simply trial by ambush. Ferrari and its dealers have consistently engaged in prehearing document discovery under the arbitrator's general supervision. Other prehearing activities typically include the identification of witnesses and the exchange of evidentiary exhibits. While prehearing depositions are generally not available, this attribute of arbitration expedites the resolution of the dispute and dramatically scales back the costs for both parties.

Arbitration thus strikes an appropriate balance by providing for pretrial exchanges of information while limiting the more vexatious aspects of discovery that have been subject to abuse in court proceedings. The use of streamlined procedures forecloses the severe disruptions that full-court litigation may otherwise cause to a party's business operations. This is especially critical to a small distributor like Ferrari, which has only approximately 35 employees in the United States.

Proponents of H.R. 534 have complained that arbitrators do not always apply the rules of evidence as strictly as their judicial counterparts. This tendency, however, does not diminish the fairness of the hearing. While arbitrators may err on the side of admitting evidence, this approach ensures that both parties have an opportunity to submit all probative materials and to fully examine witnesses. Ferrari dealers have enjoyed broad latitude to inquire in arbitration. At one recent hearing the dealer's counsel was able to question seven current or former Ferrari employees, including the company's president and chief financial officer.

Proponents of H.R. 534 have also complained that mandatory arbitration forces dealers to forego the substantive protection of State franchise statutes. This wrongly assumes that arbitrators have some predisposition to ignoring pertinent statutory standards. In fact, the arbitrators in Ferrari's cases have repeatedly applied the dealer's State franchise statute in making their determinations.

In sum, Ferrari's experience has been that arbitration offers a fair method of dispute resolution that averts the more disruptive and burdensome aspects of commercial litigation. The submission of franchise disputes to independent bodies like the American Arbitration Association does nothing to undermine a dealer's substantive rights. Instead, it merely results in the adjudication of those rights in an efficient and neutral forum.

Ferrari therefore urges the subcommittee to reject H.R. 534 as an unwarranted attempt to amend the Federal Arbitration Act and thereby override years of Federal judicial precedent in favor of arbitration. Thank you.

[The prepared statement of Mr. Isralowitz follows:]

PREPARED STATEMENT OF JASON P. ISRALOWITZ, KIRKPATRICK & LOCKHART, LLP, NEW YORK, NY

Introduction

Good morning. My name is Jason Isralowitz and I am an attorney at Kirkpatrick & Lockhart LLP, which serves as outside counsel for Ferrari North America, Inc. on franchise matters. Ferrari is the exclusive distributor of new Ferrari vehicles, parts, and accessories in North America. Thank you for inviting me to testify me on Ferrari's behalf concerning H.R. 534, the proposed Fairness and Voluntary Arbitration Act.

Ferrari strongly opposes the bill because it would prevent Ferrari from continuing to include mandatory arbitration as a term of its standard franchise agreement. Ferrari's experience has been that arbitration affords dealers and manufacturers alike a fair and efficient means of resolving their disputes.

The Ferrari dealer agreement provides that "any and all disputes a rising out of or in connection with" the agreement shall be submitted to arbitration before the American Arbitration Association ("AAA") in New York. Federal courts have repeatedly sustained this provision as a valid and enforceable agreement subject to the Federal Arbitration Act. Pursuant to the arbitration agreement, Ferrari has resolved a number of disputes with its dealers before the AAA. The procedures employed in these arbitrations disprove a number of the rationales that have been advanced in support of H.R. 534. Arbitration offers significant procedural safeguards

for the parties as well as considerable benefits not available in court or administrative proceedings.

Qualified & Independent Arbitrators

To begin with, the arbitrators presiding over Ferrari's franchise matter shave been independent and extremely well-qualified. Appointments are made from a pool of AAA arbitrators that includes former federal and state court judges, former government officials, and experienced commercial litigators.

For example, one recent panel was comprised of: the Honorable Harold R.Tyler, Jr., who served as a United States District Court Judge for the Southern District of New York for thirteen years; the Honorable Frederick B. Lacey, a U.S. District Court Judge for the District of New Jersey for fifteen years; and former U.S. Attorney General Nicholas deB Katzenbach.This is hardly the type of tribunal prone to acting in disregard of the law or to denying parties a fair hearing. Other arbitrators appointed in Ferrari's arbitrations have included a former judge of the United States Court of Appeals for the Third Circuit and a former New York State Supreme Court judge.

The availability of these experienced jurists is especially significant because both Ferrari and its dealers have input into the selection of the arbitrator. The distinguished tribunal described above was appointed after the dealer requested a three-member panel comprised of former judges or experienced litigators. In that case, as in others, the AAA permitted the parties to rank potential arbitrators in order of preference and to strike from the list any individuals they found objectionable. In short, a Ferrari dealer has far more input into the identity of the individual decision makers in arbitration than other litigants have in court or before administrative agencies.

Availability of Discovery

Once appointed in an AAA proceeding, an arbitrator has the power to direct the exchange of relevant documents prior to the hearing. The availability of such discovery dispels the claim that dealers have no ability to learn facts or gain documents prior to an arbitration hearing. In every Ferrari arbitration conducted within the past five years, the parties have engaged in significant document discovery. Where disputes have arisen about the proper scope of discovery, the arbitrators have entertained arguments from the parties and issued rulings about which documents should be produced—using the same basic test of potential relevance that applies in judicial and administrative proceedings.

In addition to document exchanges, the governing arbitration procedures also call for the pre-hearing identification of witnesses and the exchange of all evidentiary exhibits. The AAA's commercial arbitration rules empower the arbitrator to resolve any disputes concerning the exchange of this information.

As the foregoing demonstrates, arbitration provides a supervised discovery process enabling pre-hearing access to relevant documents and data. It is true that, unlike document discovery, pre-hearing depositions are generally not available in arbitration. This is one of arbitration's virtues: the lack of depositions expedites the disposition of the dispute and dramatically reduces the costs of the proceeding for both parties.

Arbitration thus strikes an appropriate balance by providing for pretrial exchanges of information while limiting the more vexatious aspects of discovery that have been subject to abuse in court proceedings. The use of streamlined procedures forecloses the severe disruption that full-court litigation may otherwise cause to a party's business operations. This is especially critical to a small distributor like Ferrari, which has only approximately 35 employees.

Evidentiary Standards

Proponents of H.R. 534 have correctly observed that arbitrators do notalways apply the rules of evidence as strictly as their judicial counterparts. The use of relaxed evidentiary standards does not, however,translate into unfairness to automobile dealers in arbitration. The arbitrator's more informal method for handling evidentiary question seliminates the excessive motion practice often found in court proceedings.And while arbitrators may tend to err on the side of admitting evidence,this approach has the virtue of ensuring that both parties can submit all probative materials and examine witnesses fully. The concerns about prejudice that inform more stringent evidentiary rules in jury trials are misplaced in the context of these arbitrations, which occur before former judges and experienced attorneys.

When compared with Ferrari manufacturers, Ferrari dealers have availed themselves of the more liberal evidentiary standards. The dealers have enjoyed broad latitude to inquire of Ferrari representatives in arbitration; in one recent hearing,

the dealer's counsel examined seven current or former Ferrari employees, including Ferrari's President and Chief Financial Officer.

Some proponents of H.R. 534 have compared arbitration unfavorably to the procedures employed by state administrative boards. Ironically, those administrative agencies themselves tend to have relaxed rules of evidence concerning such matters as hearsay and authenticity, and dealers have been generally very supportive of these agencies.

Application of Franchise Protection Statutes

Proponents of H.R. 534 have also complained that mandatory arbitration forces dealers to forego the substantive protection of state franchise statutes. This wrongly assumes that arbitrators have some predisposition to ignore pertinent statutory standards. In fact, the arbitrators in Ferrari's cases have repeatedly applied the dealer's state franchise statute in making their determinations. Ferrari has stipulated to the applicability of these statutes in most cases.

On a related note, several courts that have ruled on the enforceability of Ferrari's arbitration provision have noted that mandatory arbitration was not inconsistent with the dealer's state franchise statute. Federal judges have found, for example, that arbitration of manufacturer-dealer disputes before an independent arbitrator was not inconsistent with the Florida and California motor vehicle franchise acts. These judges have recognized that the strong federal policy in favor of arbitration does not displace the protections of the franchise statutes; rather, it only mandates that those protections be invoked in the forum chosen by the parties.

Reasoned Decisions

Another criticism of arbitration lodged by advocates of H.R. 534 is that arbitrators may not act in accordance with precedent or supply reasoning to support their decisions. As with other complaints about the arbitral process, this criticism is not borne out by Ferrari's experience. The arbitrators typically ask for briefs with citations to pertinent authority and make their decisions based on the facts and the applicable law.

In addition, the AAA has a policy of asking the parties whether they would like a decision that specifies its underlying reasoning and grounds for the result. Each time the parties requested a "reasoned decision," that request was honored. The only time a panel did not issue a detailed decision in a Ferrari arbitration over the past five years occurred when the dealer specifically requested that there not be one.

Conclusion

In sum, Ferrari's experience has been that arbitration offers a fair method of dispute resolution that averts the more burdensome and disruptive aspects of commercial litigation. The submission of manufacturer-dealer disputes to independent bodies like the AAA does nothing to undermine a dealer's substantive rights. Instead, it merely results in the adjudication of such rights in an efficient and neutral forum. Ferrari urges the Subcommittee to reject H.R. 534 as an unwarranted attempt to amend the Federal Arbitration Act and thereby override years of federal judicial precedent in favor of arbitration.

Mrs. BONO. Thank you.

Mr. Holcomb.

STATEMENT OF RICHARD HOLCOMB, COMMONWEALTH OF VIRGINIA, COMMISSIONER, DEPARTMENT OF MOTOR VEHICLES, RICHMOND, VA

Mr. HOLCOMB. Thank you, Madam Chair, and members of the subcommittee. I am pleased to have the opportunity to testify today on behalf of the Chair's bill. As Chairman Gekas mentioned, I am sort of back on home turf, having served as chief of staff for Congressman Craig James of Florida and D. French Slaughter from Virginia, who both served with distinction on the Judiciary Committee.

Madam Chair, the Commonwealth of Virginia has an inherent right to protect its citizens. As part of that right Virginia, similar to Congress in its enactment of the Dealer's Day in Court Act, has realized that there is an inherent difference or there is a manifest

disparity in the bargaining rights of dealers with their manufacturers. As such, Virginia has enacted its statutes, which levels the playing field. As the Commissioner of the Department of Motor Vehicles, it is my job to execute those laws.

I should say at this point since I testified on behalf of the companion bill in the Senate, I have been subjected to a great deal of criticism from manufacturers and their attorneys, who say that it is inappropriate for me as a State official to come before this body and testify on this bill, somehow that I am advocating a position for dealers or dealerships. Madam Chair, let me make this perfectly clear. I am here advocating the Virginia laws that have been properly enacted by our General Assembly and signed by our Governor, no more, no less. I am not opposed, or we are not opposed to arbitration. All we want is to make sure that the Virginia businesses have as many forums as possible to air their grievances.

Just to compare the two, routinely, arbitration does not provide for discovery. Under the Virginia system, prehearing discovery is provided for. An arbiter is not bound by the rules of evidence. In Virginia the trier of fact is bound by the Virginia rules of evidence. There is no precedent binding on the arbiter nor does the arbiter's decision set precedent. In Virginia the trier of fact is bound by precedents and, since a written decision is rendered, that in and of itself sets precedent. In fact we provide synopses of those decisions to manufacturers and dealers so that they are aware of the precedent.

Finally, there is no right of an appeal on a decision by an arbiter, while my decisions are appealable. That last issue may lead some to say, if you eliminated arbitration the courts will be inundated with these types of cases. Over the last 4 years in Virginia I have had 55 requests for hearings. Of those, 35 have been resolved to the mutual satisfaction of both parties prior to the hearing. Of the 20 remaining, nine are currently pending, three I determined were not entitled to a hearing and denied their request and eight led to a final decision. Of those, three were appealed to circuit court. Of those three appeals, one was withdrawn by the manufacturer prior to the circuit court hearing it, the remaining two the circuit court upheld my decision, one was in favor of the manufacturer and one was in favor of a dealer. So the last 4 years, 53 of the 55 disputes between Virginia dealers and manufacturers were resolved without having to go to court.

In Virginia our law has been preempted by the Federal under the FAA. In 1989 my predecessor had a case with Saturn where Saturn came in with a binding arbitration agreement. We just suggest that possibly it would be useful to have an addendum that would make it voluntary, that would say that the Virginia business was entitled to the Virginia laws and protections. Saturn disagreed with that, sued us. We won the case in district court, lost it on a split decision in the Fourth Circuit Court of Appeals.

In sum, Madam Chair, I am here as a State official advocating States rights, advocating that the Virginia businessmen and women have the rights and processes and protection provided by our General Assembly, and I thank you for the opportunity.

[The prepared statement of Mr. Holcomb follows:]

PREPARED STATEMENT OF RICHARD HOLCOMB, COMMONWEALTH OF VIRGINIA, COMMISSIONER, DEPARTMENT OF MOTOR VEHICLES, RICHMOND, VA

INTRODUCTION

I would like to thank the Subcommittee on Commercial and Administrative Law for giving me the opportunity to testify on H.R. 534, the Fairness and Voluntary Arbitration Act of 2000. Since March 1994, I have served as the Commissioner of the Virginia Department of Motor Vehicles. DMV administers the dispute process between motor vehicle dealers and manufacturers, as well as franchise laws. In 1995, the Motor Vehicle Dealer Board, which I serve on as chairman, was created to license automobile and truck dealers in Virginia. Today, I wish to speak in favor of H.R. 534. The bill will allow the creation of a level playing field for both motor vehicle dealers and manufacturers to choose mutually acceptable forms of dispute resolution.

On March 1, 2000, I testified before the U.S. Senate Judiciary Subcommittee on Administrative Oversight and the Courts in favor of H.R. 534's companion bill (Senate Bill 1020), the Motor Vehicle Franchise Contract Arbitration Fairness Act of 2000. Since that time, I have received criticism from manufacturers implying that I acted as an advocate on behalf of Virginia dealers. I strongly object to this categorization of my actions as advocacy for anything other than Virginia motor vehicle franchise law. As Commissioner, it is my duty to uphold the provisions of Title 46.2, Chapter 15 of the *Code of Virginia*. My actions then and now serve no other purpose than to ask that Virginia businesses be afforded the protections and procedures enacted by our state legislature and signed by our governor.

PROBLEM

Motor vehicle manufacturers are forcing small business auto and truck dealers into mandatory binding arbitration clauses by including the clauses in non-negotiated dealer agreements. Legitimate state protections, however, are unavailable for dealers with arbitration contracts because of overly broad federal policy favoring arbitration. In a landmark case, *Southland Corporation* v. *Keating*, 107 S.Ct. 852 (1984), the U.S. Supreme Court held that state laws that prohibit mandatory binding arbitration in adhesion contracts or prohibit waiver of judicial or administrative remedies as a contract are preempted. Unfortunately, preemption prevents states from enforcing protective laws that limit or regulate unfair arbitration practices in contracts, despite the fact that enforceability of private contracts is ordinarily a question of state law. These arbitration clauses substantially deteriorate dealers' rights and remedies as provided under protective state franchise laws.

PROPOSED REMEDY

H.R. 534 proposes to make arbitration of dealer-manufacturer disputes totally voluntary. This proposed legislation does not prohibit arbitration but does seek to offer arbitration as one of several possible avenues to problem resolution. It ensures that arbitration is used only when both parties to a sales and service contract voluntarily agree, thereby preventing manufacturers from forcing dealers to prospectively waive protective state rights, remedies and procedures otherwise available. In cases where the two parties voluntarily elect arbitration to settle a dispute, the proposed legislation provides for written explanation of the factual and legal basis for the award.

BACKGROUND

Under current law, dealers have no choice but to accept a mandatory binding arbitration provision in a franchise agreement. Automobile and truck manufacturers present dealers with traditional adhesion contracts. Since dealers cannot delete the mandatory binding arbitration provision, the manufacturer is coercing the dealer into binding arbitration as the only method of resolving disputes.

This practice forces dealers to submit their disputes with manufacturers to arbitration. As a result, dealers are forced to waive access to judicial or administrative forums, substantive contract rights and statutorily provided protection. This practice clearly violates the dealers' fundamental due process rights and runs counter to basic principles of fairness.

Arbitration lacks several of the important safeguards and due process offered by administrative procedures and the judicial system. Arbitration lacks the formal court-supervised discovery process often necessary to learn facts and gain documents. An arbitrator does not need to follow the rules of evidence. Arbitrators generally have no obligation to provide factual or legal discussion of the decision in a written opinion. And, arbitration often does not allow for judicial review. Thus, a

dealer seeking to overturn an arbitration decision may be unable to appeal the decision. Further, an arbitrator's misinterpretation or misapplication of the law is not subject to court review.

Dealers have clear and enforceable rights under state franchise laws that protect small business dealers from a host of documented manufacturer abuses. Generally, however, arbitrators are not bound by state law in their decisions. As a result, arbitration allows manufacturers to circumvent state laws and the protections they provide to dealers.

ALTERNATIVE DISPUTE RESOLUTION MECHANISMS USED BY STATES

The majority of states have created their own alternative dispute resolution mechanisms with access to auto industry expertise that provide inexpensive, efficient and non-judicial resolution of disputes. For example, Virginia Code, § 46.2–1573 (a copy of which is attached) establishes a standard hearing process and designates specific time frames for each step in the process.

1. Upon receipt of the request for a hearing, DMV contacts the executive secretary of the Virginia Supreme Court for the appointment of a hearing officer. The hearing process commences within 90 days of the dealer request. Certain types of hearings require the appointment of a three-member dealer board panel by the DMV Commissioner. The hearing officer may hold a pre-hearing conference to establish procedural dates, notify foreign attorneys of participation, prepare exhibits and identify witnesses, identify issues and stipulations, determine the order of presentation, make requests for admissions, depositions and subpoenas.
2. The hearing officer must provide recommendations to the DMV Commissioner within 90 days of the conclusion of the hearing.
3. The DMV Commissioner must render a decision within 60 days from receipt of the hearing officer's recommendation. Under these statutory provisions, a hearing should be completed within 240 days or eight months.
4. Additionally, the Commissioner's decision may be appealed to an appropriate Virginia Circuit Court within 33 days of the decision date.

Unlike arbitration, the hearing process provides written documentation of the findings and decision. This documentation establishes precedents for subsequent cases. Further, the Virginia Motor Vehicle Dealer Board publishes the results of hearings in a newsletter to Virginia's motor vehicle dealers and manufacturers.

EFFICACY OF THE VIRGINIA HEARING SYSTEM

The efficacy of Virginia's hearing system for equitably resolving disputes between manufacturers and dealers can be demonstrated through a review of the state's caseload between 1996 and 2000.

During that period, the Department of Motor Vehicles (DMV) received 55 requests for hearings. However, 35 of those requests were resolved prior to a hearing. That is, the requests for a hearing were withdrawn because both sides, working together, were able to negotiate a mutually acceptable solution. In other words, when manufacturers realized that they were facing an objective, standardized hearing process, they decided to take the dealer's issue seriously and to negotiate a mutually acceptable agreement.

Of the remaining 20 hearing requests, I as Commissioner rendered a decision eight times, three requests were denied and nine requests are currently pending. Since 1996, my decision has been appealed three times. Of those, one was withdrawn by the manufacturer and two were won by DMV (one where we had ruled in favor of the manufacturer and one where we had ruled in favor of the dealer). Currently, seven hearing requests are in process, including two pending appeals.

Clearly, the Virginia system quickly and efficiently resolves manufacturer/dealer disputes while preserving all the remedies to which dealers, and any small business owner, should have recourse.

VIRGINIA BACKGROUND

All states except Alaska have enacted substantive law to balance the enormous bargaining power enjoyed by manufacturers over dealers and to safeguard small business dealers from unfair automobile and truck manufacturer practices. Many states, recognizing that mandatory binding arbitration provisions in contracts nullify their state statutes and procedures, have enacted laws to prohibit inclusion of mandatory binding clauses in certain agreements. As previously noted, the courts have held that these state laws are preempted by the *Federal Arbitration Act* (FAA).

Courts have interpreted preemption in the FAA provisions that declare arbitration agreements "valid, irrevocable and enforceable."

Virginia has first-hand experience with the preemption issue. In 1989, Saturn Corporation, a General Motors subsidiary, challenged a Virginia law prohibiting mandatory binding arbitration. Saturn filed suit against the State of Virginia when Virginia refused to approve Saturn's franchise agreement. The Saturn agreement was rejected because it mandated binding arbitration and denied dealers access to the procedures, forums and remedies provided in state law.

The federal district court ruled in favor of the State of Virginia, *Saturn Distribution Corp.* v. *Williams*, 717 F. Supp. 1147 (E.D. VA. 1989). However, the Fourth Circuit Court of Appeals reversed the district court, holding that the Virginia dealer law prohibiting mandatory binding arbitration conflicts with the FAA and is preempted by the Supremacy Clause of the U.S. Constitution, *Saturn Distribution Corp.* v. *Williams*, 905 F.2d 719 (4th Cir. 1990). The Appellate Court relied on two Supreme Court decisions, *Southland Corporation* v. *Keating*, 104 S.CT. 852 (1984) and *Perry* v. *Thomas*, 107 S.CT. 2520 (1987).

When Congress enacted the FAA in 1925, the narrow intent of Congress was to make arbitration awards enforceable in federal courts. The purpose of the Act was to overrule the long-standing hostility to arbitration and the failure of courts to enforce arbitration decisions in arms-length transactions.

Legal commentators have argued that Congress never intended the FAA to apply arbitration agreements that would allow a stronger party to a contract to force a weaker party to relinquish rights to a judicial forum and other dispute resolution forums as a condition of entering into a contract.

The FAA does not expressly provide for preemption of state law, nor is there an explicit Congressional intent to occupy the entire field of arbitration. However, in recent years, the Supreme Court has clearly interpreted the FAA to preempt state law (refer to *Southland*). This decision has had the effect of preempting state laws that protect the weaker party from being forced to accept arbitration.

The *Saturn* decision further supported the Supreme Court's interpretation and also frustrates Congressional intent as expressed by the Dealer's Day in Court Act, 15 U.S.C. § 1221–1225. Through this legislation, Congress granted automobile dealers access to the federal courts to seek relief against manufacturers. Recognizing the disparity in bargaining power between manufacturers and dealers, Congress sought to level the playing field by providing protection for dealers.

CONCLUSION

The Fairness and Voluntary Arbitration Act of 2000 provides that each party to an auto or truck franchise contract will have the choice to select arbitration. This bill does not prohibit arbitration. On the contrary, the bill encourages arbitration by making it a fair choice that both parties to a franchise contract may willingly and knowingly select. In short, this bill will ensure that the decision to arbitrate is truly voluntary and that the rights and remedies provided for by the state's judicial and administrative system are not waived under coercion.

ACTION ITEM

I would therefore urge this subcommittee to approve H.R. 534. Again, thank you for the opportunity to testify today. I will be glad to answer any of your questions.

ATTACHMENT

ARTICLE 7. FRANCHISES.

§ 46.2–1566. Filing of franchises

A. It shall be the responsibility of each motor vehicle manufacturer, factory branch, distributor, distributor branch, or subsidiary thereof to file with the Commissioner by certified mail a true copy of each new, amended, modified, or different form or addendum offered to more than one dealer which affects the rights, responsibilities, or obligations of the parties of a franchise or sales, service, or sales and service agreement to be offered to a motor vehicle dealer or prospective motor vehicle dealer in the Commonwealth no later than sixty days prior to the date the franchise or sales agreement is offered. In no event shall a new, amended, modified, or different form of franchise or sales, service, or sales and service agreement be offered a motor vehicle dealer in the Commonwealth until the form has been determined by the Commissioner as not containing terms inconsistent with the provisions of this chapter. At the time a filing is made with the Commissioner pursuant to this section, the manufacturer, factory branch, distributor, distributor branch, or subsidi-

ary shall also give written notice together with a copy of the papers so filed to the affected dealer or dealers.

B. The Department shall inform the manufacturer, factory branch, distributor, distributor branch, or subsidiary and the dealer or dealers or other parties named in the agreement of a preliminary recommendation as to the consistency of the agreement with the provisions of this chapter. If any of the parties involved have comments on the preliminary recommendation, they must be submitted to the Commissioner within thirty days of receiving the preliminary recommendation. The Commissioner shall render his decision within fifteen days of receiving comments from the parties involved. If the Commissioner does not receive comments within the thirty-day time period, he shall make the final determination as to the consistency of the agreement with the provisions of this chapter.

§ 46.2–1567. Exemption of franchises from Retail Franchising Act

Franchises subject to the provisions of this chapter shall not be subject to any requirement contained in Chapter 8 (§ 13.1–557 et seq.) of Title 13.1.

§ 46.2–1568. Coercion of retail dealer by manufacturer or distributor with respect to retail installment sales contracts prohibited; penalty.

A. It shall be unlawful for any manufacturer or distributor, or any officer, agent, or representative of either, to coerce or attempt to coerce any retail motor vehicle dealer or prospective retail motor vehicle dealer in the Commonwealth to sell, assign, or transfer any retail installment sales contract obtained by the dealer in connection with the sale by him in the Commonwealth of motor vehicles manufactured or sold by the manufacturer or distributor, to a specified finance company or class of finance companies or to any other specified persons by any of the following:

1. By any statement, suggestion, promise, or threat that the manufacturer or distributor will in any manner benefit or injure the dealer, whether the statement, suggestion, threat, or promise is express or implied or made directly or indirectly.

2. By any act that will benefit or injure the dealer.

3. By any contract, or any express or implied offer of contract, made directly or indirectly to the dealer, for handling the motor vehicle on the condition that the dealer sell, assign, or transfer his retail installment sales contract on the vehicle, in the Commonwealth, to a specified finance company or class of finance companies or to any other specified person.

4. By any express or implied statement or representation made directly or indirectly that the dealer is under any obligation whatsoever to sell, assign, or transfer any of his retail sales contracts in the Commonwealth on motor vehicles manufactured or sold by the manufacturer or distributor to a finance company, or class of finance companies, or other specified person, because of any relationship or affiliation between the manufacturer or distributor and the finance company or companies or the specified person or persons.

B. Any such statements, threats, promises, acts, contracts, or offers of contracts, when their effect may be to lessen or eliminate competition or tend to create a monopoly, are declared unfair trade practices and unfair methods of competition and are prohibited.

C. Any person found guilty of violating any of the provisions of this section shall be guilty of a Class 1 misdemeanor.

§ 46.2–1569. Other coercion of dealers; transfer, grant, succession to and cancellation of dealer franchises; delivery of vehicles, parts, and accessories.

Notwithstanding the terms of any franchise agreement, it shall be unlawful for any manufacturer, factory branch, distributor, or distributor branch, or any field representative, officer, agent, or their representatives:

1. To coerce or attempt to coerce any dealer to accept delivery of any motor vehicle or vehicles, parts or accessories therefor, or any other commodities, which have not been ordered by the dealer.

2. To coerce or attempt to coerce any dealer to enter into an agreement with the manufacturer, factory branch, distributor, or distributor branch, or representative thereof, or do any other act unfair to the dealer, by threatening to cancel any franchise existing between the manufacturer, factory branch, distributor, distributor branch, or representative thereof and the dealer.

2a. To coerce or attempt to coerce any dealer to join, contribute to, or affiliate with any advertising association.

3. To prevent or refuse to approve the sale or transfer of the ownership of a dealership by the sale of the business, stock transfer, or otherwise, or the transfer, sale, or assignment of a dealer franchise, or a change in the executive management or principal operator of the dealership, unless the franchisor provides written notice to the dealer of its objection and the reasons therefor at least thirty days prior to the

proposed effective date of the transfer, sale, assignment, or change. No such objection shall be effective to prevent the sale, transfer, assignment, or change if the Commissioner has determined, if requested in writing by the dealer within thirty days after receipt of an objection to the proposed sale, transfer, or change, and after a hearing on the matter, that the failure to permit or honor the sale, transfer, assignment, or change is unreasonable under the circumstances. No franchise may be sold, assigned, or transferred unless (i) the franchisor has been given at least ninety days' prior written notice by the dealer as to the identity, financial ability, and qualifications of the proposed transferee, and (ii) the sale or transfer of the franchise and business will not involve, without the franchisor's consent, a relocation of the business.

4. To grant an additional franchise for a particular line-make of motor vehicle in a relevant market area in which a dealer or dealers in that line-make are already located unless the franchisor has first advised in writing all other dealers in the line-make in the relevant market area. No such additional franchise may be established at the proposed site unless the Commissioner has determined, if requested by a dealer of the same line-make in the relevant market area within thirty days after receipt of the franchisor's notice of intention to establish the additional franchise, and after a hearing on the matter, that there is reasonable evidence that after the grant of the new franchise, the market will support all of the dealers in that line-make in the relevant market area. Establishing a franchised dealer in a relevant market area to replace a franchised dealer that has not been in operation for more than two years shall constitute the establishment of a new franchise subject to the terms of this subdivision. The two-year period for replacing a franchised dealer shall begin on the day the franchise was terminated, or, if a termination hearing was held, on the day the franchisor was legally permitted finally to terminate the franchise. This subdivision shall not apply to (i) the relocation of an existing dealer within that dealer's relevant market area if the relocation site is to be more than ten miles distant from any other dealer for the same line-make; (ii) the relocation of an existing dealer within that dealer's relevant market area if the relocation site is to be more distant than the existing site from all other dealers of the same line-make in that relevant market area; or (iii) the relocation of an existing new motor vehicle dealer within two miles of the existing site of the relocating dealer.

5. Except as otherwise provided in this subdivision and notwithstanding the terms of any franchise, to terminate, cancel, or refuse to renew the franchise of any dealer without good cause and unless (i) the dealer and the Commissioner have received written notice of the franchisor's intentions at least sixty days prior to the effective date of such termination, cancellation, or the expiration date of the franchise, setting forth the specific grounds for the action, and (ii) the Commissioner has determined, if requested in writing by the dealer within the sixty-day period and, after a hearing on the matter, that there is good cause for the termination, cancellation, or nonrenewal of the franchise. In any case where a petition is made to the Commissioner for a determination as to good cause for the termination, cancellation, or nonrenewal of a franchise, the franchise in question shall continue in effect pending the Commissioner's decision or, if that decision is appealed to the circuit court, pending the decision of the circuit court. In any case in which a franchisor neither advises a dealer that it does not intend to renew a franchise nor takes any action to renew a franchise beyond its expiration date, the franchise in question shall continue in effect on the terms last agreed to by the parties. Notwithstanding the other provisions of this subdivision notice of termination, cancellation, or nonrenewal may be provided to a dealer by a franchisor not less than fifteen days prior to the effective date of such termination, cancellation, or nonrenewal when the grounds for such action are any of the following:

a. Insolvency of the franchised motor vehicle dealer or filing of any petition by or against the franchised motor vehicle dealer, under any bankruptcy or receivership law, leading to liquidation or which is intended to lead to liquidation of the franchisee's business.

b. Failure of the franchised motor vehicle dealer to conduct its customary sales and service operations during its posted business hours for seven consecutive business days, except where the failure results from acts of God or circumstances beyond the direct control of the franchised motor vehicle dealer.

c. Revocation of any license which the franchised motor vehicle dealer is required to have to operate a dealership.

d. Conviction of the dealer or any principal of the dealer of a felony.

The change or discontinuance of a marketing or distribution system of a particular line-make product by a manufacturer or distributor, while the name identification of the product is continued in substantial form by the same or a different manufacturer or distributor, may be considered to be a franchise termination, cancella-

tion, or nonrenewal. The provisions of this paragraph shall apply to changes and discontinuances made after January 1, 1989, but they shall not be considered by any court in any case in which such a change or discontinuance occurring prior to that date has been challenged as constituting a termination, cancellation or nonrenewal.

5a. To fail to provide continued parts and service support to a dealer which holds a franchise in a discontinued line-make for at least five years from the date of such discontinuance. This requirement shall not apply to a line-make which was discontinued prior to January 1, 1989.

6. To fail to allow a dealer the right at any time to designate a member of his family as a successor to the dealership in the event of the death or incapacity of the dealer. It shall be unlawful to prevent or refuse to honor the succession to a dealership by a member of the family of a deceased or incapacitated dealer if the franchisor has not provided to the member of the family previously designated by the dealer as his successor written notice of its objections to the succession and of such person's right to seek a hearing on the matter before the Commissioner pursuant to this article, and the Commissioner determines, if requested in writing by such member of the family within thirty days of receipt of such notice from the franchisor, and after a hearing on the matter before the Commissioner pursuant to this article, that the failure to permit or honor the succession is unreasonable under the circumstances. No member of the family may succeed to a franchise unless (i) the franchisor has been given written notice as to the identity, financial ability, and qualifications of the member of the family in question, and (ii) the succession to the franchise will not involve, without the franchisor's consent, a relocation of the business.

7. To fail to ship monthly to any dealer, if ordered by the dealer, the number of new vehicles of each make, series, and model needed by the dealer to receive a percentage of total new vehicle sales of each make, series, and model equitably related to the total new vehicle production or importation currently being achieved nationally by each make, series, and model covered under the franchise. Upon the written request of any dealer holding its sales or sales and service franchise, the manufacturer or distributor shall disclose to the dealer in writing the basis upon which new motor vehicles are allocated, scheduled, and delivered to the dealers of the same line-make. In the event that allocation is at issue in a request for a hearing, the dealer may demand the Commissioner to direct that the manufacturer or distributor provide to the dealer, within thirty days of such demand, all records of sales and all records of distribution of all motor vehicles to the same line-make dealers who compete with the dealer requesting the hearing.

7a. To fail or refuse to offer to its same line-make franchised dealers all models manufactured for the line-make, or require a dealer to pay any extra fee, or remodel, renovate, or recondition the dealer's existing facilities, or purchase unreasonable advertising displays or other materials as a prerequisite to receiving a model or a series of vehicles.

7b. To require or otherwise coerce a dealer to underutilize the dealer's facilities.

8. To include in any franchise with a motor vehicle dealer terms that are contrary to, prohibited by, or otherwise inconsistent with the requirements of this chapter.

8a. For any franchise agreement, to require a motor vehicle dealer to pay the attorney's fees of the manufacturer or distributor related to hearings and appeals brought under this article.

9. To fail to include in any franchise with a motor vehicle dealer the following language: "If any provision herein contravenes the laws or regulations of any state or other jurisdiction wherein this agreement is to be performed, or denies access to the procedures, forums, or remedies provided for by such laws or regulations, such provision shall be deemed to be modified to conform to such laws or regulations, and all other terms and provisions shall remain in full force," or words to that effect.

§ 46.2–1569.1. Manufacturer or distributor right of first refusal.

Notwithstanding the terms of any franchise agreement, in the event of a proposed sale or transfer of a dealership, the manufacturer or distributor shall be permitted to exercise a right of first refusal to acquire the new vehicle dealer's assets or ownership, if such sale or transfer is conditioned upon the manufacturer's or dealer's entering into a dealer agreement with the proposed new owner or transferee, only if all the following requirements are met:

1. To exercise its right of first refusal, the manufacturer or distributor must notify the dealer in writing within forty-five days of its receipt of the completed proposal for the proposed sale transfer;

2. The exercise of the right of first refusal will result in the dealer's and dealer's owner's receiving the same or greater consideration as they have contracted to receive in connection with the proposed change of ownership or transfer;

3. The proposed sale or transfer of the dealership's assets does not involve the transfer or sale to a member or members of the family of one or more dealer owners, or to a qualified manager or a partnership or corporation controlled by such persons; and

4. The manufacturer or distributor agrees to pay the reasonable expenses, including attorney's fees which do not exceed the usual, customary, and reasonable fees charged for similar work done for other clients, incurred by the proposed new owner and transferee prior to the manufacturer's or distributor's exercise of its right of first refusal in negotiating and implementing the contract for the proposed sale or transfer of the dealership or dealership assets. Notwithstanding the foregoing, no payment of such expenses and attorney's fees shall be required if the dealer has not submitted or caused to be submitted an accounting of those expenses within thirty days of the dealer's receipt of the manufacturer's or distributor's written request for such an accounting. Such accounting may be requested by a manufacturer or distributor before exercising its right of first refusal.

§ 46.2–1570. Discontinuation of distributors.

If the contract between a distributor and a manufacturer or importer is terminated or otherwise discontinued, all franchises granted to motor vehicle dealers in Virginia by that distributor shall continue in full force and shall not be affected by the discontinuance, except that the manufacturer, factory branch, distributor, representative, or other person who undertakes to distribute motor vehicles of the same line-make or the same motor vehicles of a re-named line-make shall be substituted for the discontinued distributor under the existing motor vehicle dealer franchises and those franchises shall be modified accordingly.

§ 46.2–1571. Warranty obligations.

A. Each motor vehicle manufacturer, factory branch, distributor, or distributor branch shall (i) specify in writing to each of its motor vehicle dealers licensed in the Commonwealth the dealer's obligations for preparation, delivery, and warranty service on its products and (ii) compensate the dealer for warranty parts, service and diagnostic work required of the dealer by the manufacturer or distributor as follows:

1. Compensation of a dealer for warranty parts, service and diagnostic work shall not be less than the amounts charged by the dealer for the manufacturer's or distributor's original parts, service and diagnostic work to retail customers for nonwarranty service, parts and diagnostic work installed or performed in the dealer's service department unless the amounts are not reasonable. Warranty parts compensation shall be stated as a percentage of markup, which shall be an agreed reasonable approximation of retail markup and which shall be uniformly applied to all of the manufacturer's or distributor's parts unless otherwise provided for in this section. If the dealer and manufacturer or distributor cannot agree on the warranty parts compensation markup to be paid to the dealer, the markup shall be determined by an average of the dealer's retail markup on all of the manufacturer's or distributor's parts as described in subdivisions 2 and 3 of this subsection.

2. For purposes of determining warranty parts and service compensation paid to a dealer by the manufacturer or distributor, menu-priced parts or services, group discounts, special event discounts, and special event promotions shall not be considered in determining amounts charged by the dealer to retail customers. For purposes of determining labor compensation for warranty body shop repairs paid to a dealer by the manufacturer or distributor, internal and insurance-paid repairs shall not be considered in determining amounts charged by the dealer to retail customers.

3. Increases in dealer warranty parts and service compensation and diagnostic work compensation, pursuant to this section, shall be requested by the dealer in writing, shall be based on 100 consecutive repair orders or all repair orders over a ninety-day period, whichever occurs first and, in the case of parts, shall be stated as a percentage of markup which shall be uniformly applied to all the manufacturer's or distributor's parts.

4. In the case of warranty parts compensation, the provisions of this subsection shall be effective only for model year 1992 and succeeding model years.

5. If a manufacturer or distributor furnishes a part to a dealer at no cost for use by the dealer in performing work for which the manufacturer or distributor is required to compensate the dealer under this section, the manufacturer or distributor shall compensate the dealer for the part in the same manner as warranty parts compensation, less the wholesale costs, for such part as listed in the manufacturer's

current price schedules. A manufacturer or distributor may pay the dealer a reasonable handling fee instead of the compensation otherwise required by this subsection for special high-performance complete engine assemblies in limited production motor vehicles which constitute less than five percent of model production furnished to the dealer at no cost, if the manufacturer or distributor excludes such special high-performance complete engine assemblies in determining whether the amounts requested by the dealer for warranty compensation are consistent with the amounts that the dealer charges its other retail service customers for parts used by the dealer to perform similar work.

6. In the case of service work, manufacturer original parts or parts otherwise specified by the manufacturer or distributor, and parts provided by a dealer either pursuant to an adjustment program as defined in *§ 59.1–207.34* or as otherwise requested by the manufacturer or distributor, the dealer shall be compensated in the same manner as for warranty service or parts.

This section does not apply to compensation for parts such as components, systems, fixtures, appliances, furnishings, accessories, and features that are designed, used, and maintained primarily for nonvehicular, residential purposes. Warranty and sales incentive audits of dealer records may be conducted by the manufacturer, factory branch, distributor, or distributor branch on a reasonable basis, and dealer claims for warranty or sales incentive compensation shall not be denied except for good cause, such as performance of nonwarranty repairs, lack of material documentation, fraud, or misrepresentation. A dealer's failure to comply with the specific requirements of the manufacturer or distributor for processing the claim shall not constitute grounds for the denial of the claim or reduction of the amount of compensation to the dealer as long as reasonable documentation or other evidence has been presented to substantiate the claim. Claims for dealer compensation shall be paid within thirty days of dealer submission or within thirty days of the end of an incentive program or rejected in writing for stated reasons. The manufacturer, factory branch, distributor, or distributor branch shall reserve the right to reasonable periodic audits to determine the validity of all such paid claims for dealer compensation. Any chargebacks for warranty parts or service compensation and service incentives shall only be for the twelve-month period immediately following the date of the claim and, in the case of chargebacks for sales compensation only, for the eighteen-month period immediately following the date of claim. However, such limitations shall not be effective in the case of intentionally false or fraudulent claims. A dealer shall not be charged back or otherwise liable for sales incentives or charges related to a motor vehicle sold by the dealer and subsequently exported, provided the dealer can demonstrate that he exercised due diligence and that the sale was made in good faith and without knowledge of the purchaser's intention to export the motor vehicle.

B. It shall be unlawful for any motor vehicle manufacturer, factory branch, distributor, or distributor branch to:

1. Fail to perform any of its warranty obligations, including tires, with respect to a motor vehicle;

2. Fail to assume all responsibility for any liability resulting from structural or production defects;

3. Fail to include in written notices of factory recalls to vehicle owners and dealers the expected date by which necessary parts and equipment will be available to dealers for the correction of defects;

4. Fail to compensate any of the motor vehicle dealers licensed in the Commonwealth for repairs effected by the dealer of merchandise damaged in manufacture or transit to the dealer where the carrier is designated by the manufacturer, factory branch, distributor, or distributor branch;

5. Fail to compensate its motor vehicle dealers licensed in the Commonwealth for warranty parts, work, and service pursuant to subsection A of this section, or for legal costs and expenses incurred by such dealers in connection with warranty obligations for which the manufacturer, factory branch, distributor, or distributor branch is legally responsible or which the manufacturer, factory branch, distributor, or distributor branch imposes upon the dealer;

6. Misrepresent in any way to purchasers of motor vehicles that warranties with respect to the manufacture, performance, or design of the vehicle are made by the dealer, either as warrantor or co-warrantor;

7. Require the dealer to make warranties to customers in any manner related to the manufacture, performance, or design of the vehicle; or

8. Shift or attempt to shift to the motor vehicle dealer, directly or indirectly, any liabilities of the manufacturer, factory branch, distributor or distributor branch under the Virginia Motor Vehicle Warranty Enforcement Act (*§ 59.1–207.9* et seq.), unless such liability results from the act or omission by the dealer.

C. Notwithstanding the terms of any franchise, it shall be unlawful for any motor vehicle manufacturer, factory branch, distributor, or distributor branch to fail to indemnify and hold harmless its motor vehicle dealers against any losses or damages arising out of complaints, claims, or suits relating to the manufacture, assembly, or design of motor vehicles, parts, or accessories, or other functions by the manufacturer, factory branch, distributor, or distributor branch beyond the control of the dealer, including, without limitation, the selection by the manufacturer, factory branch, distributor, or distributor branch of parts or components for the vehicle or any damages to merchandise occurring in transit to the dealer where the carrier is designated by the manufacturer, factory branch, distributor, or distributor branch. The dealer shall notify the manufacturer of pending suits in which allegations are made which come within this subsection whenever reasonably practicable to do so. Every motor vehicle dealer franchise issued to, amended, or renewed for motor vehicle dealers in Virginia shall be construed to incorporate provisions consistent with the requirements of this subsection.

D. On any new motor vehicle, any uncorrected damage or any corrected damage exceeding three percent of the manufacturer's or distributor's suggested retail price as defined in 15 U.S.C. § 1231–1233, as measured by retail repair costs, must be disclosed to the dealer in writing prior to delivery. Factory mechanical repair and damage to glass, tires, and bumpers are excluded from the three percent rule when properly replaced by identical manufacturer's or distributor's original equipment or parts. Whenever a new motor vehicle is damaged in transit, when the carrier or means of transportation is determined by the manufacturer or distributor, or whenever a motor vehicle is otherwise damaged prior to delivery to the new motor vehicle dealer, the new motor vehicle dealer shall:

1. Notify the manufacturer or distributor of the damage within three business days from the date of delivery of the new motor vehicle to the new motor vehicle dealership or within the additional time specified in the franchise; and

2. Request from the manufacturer or distributor authorization to replace the components, parts, and accessories damaged or otherwise correct the damage, unless the damage to the vehicle exceeds the three percent rule, in which case the dealer may reject the vehicle within three business days.

E. If the manufacturer or distributor refuses or fails to authorize correction of such damage within ten days after receipt of notification, or if the dealer rejects the vehicle because damage exceeds the three percent rule, ownership of the new motor vehicle shall revert to the manufacturer or distributor, and the new motor vehicle dealer shall have no obligation, financial or otherwise, with respect to such motor vehicle. Should either the manufacturer, distributor, or the dealer elect to correct the damage or any other damage exceeding the three percent rule, full disclosure shall be made by the dealer in writing to the buyer and an acknowledgement by the buyer is required. If there is less than three percent damage, no disclosure is required, provided the damage has been corrected. Predelivery mechanical work shall not require a disclosure. Failure to disclose any corrected damage within the knowledge of the selling dealer to a new motor vehicle in excess of the three percent rule shall constitute grounds for revocation of the buyer order, provided that, within thirty days of purchase, the motor vehicle is returned to the dealer with an accompanying written notice of the grounds for revocation. In case of revocation pursuant to this section, the dealer shall accept the vehicle and refund any payments made to the dealer in connection with the transaction, less a reasonable allowance for the consumer's use of the vehicle as defined in *§ 59.1–207.11.*

F. If there is a dispute between the manufacturer, factory branch, distributor, or distributor branch and the dealer with respect to any matter referred to in subsection A, B, or C of this section, either party may petition the Commissioner in writing, within thirty days after either party has given written notice of the dispute to the other, for a hearing. The decision of the Commissioner shall be binding on the parties, subject to rights of judicial review and appeal as provided in Chapter 1.1:1 (*§ 9–6.14:1* et seq.) of Title 9. However, nothing contained in this section shall give the Commissioner any authority as to the content or interpretation of any manufacturer's or distributor's warranty.

§ 46.2–1572. Operation of dealership by manufacturer.

It shall be unlawful for any motor vehicle manufacturer, factory branch, distributor, distributor branch, or subsidiary thereof, to own, operate, or control any motor vehicle dealership in the Commonwealth. However, this section shall not prohibit:

1. The operation by a manufacturer, factory branch, distributor, distributor branch, or subsidiary thereof, of a dealership for a temporary period, not to exceed one year, during the transition from one owner or operator to another;

2. The ownership or control of a dealership by a manufacturer, factory branch, distributor, distributor branch, or subsidiary thereof, while the dealership is being sold under a bona fide contract or purchase option to the operator of the dealership;

3. The ownership, operation, or control of a dealership by a manufacturer, factory branch, distributor, distributor branch, or subsidiary thereof, if the manufacturer, factory branch, distributor, distributor branch, or subsidiary has been engaged in the retail sale of motor vehicles through the dealership for a continuous period of three years prior to July 1, 1972, and if the Commissioner determines, after a hearing on the matter at the request of any party, that there is no dealer independent of the manufacturer or distributor, factory branch or distributor branch, or subsidiary thereof available in the community to own and operate the franchise in a manner consistent with the public interest;

4. The ownership, operation, or control of a dealership by a manufacturer, factory branch, distributor, distributor branch, or subsidiary thereof if the Commissioner determines, after a hearing at the request of any party, that there is no dealer independent of the manufacturer or distributor, factory branch or distributor branch, or subsidiary thereof available in the community or trade area to own and operate the franchise in a manner consistent with the public interest;

5. The ownership, operation, or control of a dealership dealing exclusively with school buses by a school bus manufacturer or school bus parts manufacturer or a person who assembles school buses; or

6. The ownership, operation, or control of a dealership dealing exclusively with refined fuels truck tanks by a manufacturer of refined fuels truck tanks or by a person who assembles refined fuels truck tanks.

§ 46.2–1572.1. Ownership of service facilities.

It shall be unlawful for any motor vehicle manufacturer, factory branch, distributor, distributor branch, or subsidiary thereof, to own, operate, or control, either directly or indirectly, any motor vehicle warranty or service facility located in the Commonwealth. Nothing in this section shall prohibit any motor vehicle manufacturer, factory branch, distributor, distributor branch, or subsidiary thereof, from owning, operating, or controlling any warranty or service facility for warranty or service of motor vehicles owned or operated by the manufacturer, factory branch, distributor, distributor branch, or subsidiary thereof. Nothing contained in this section shall prohibit a motor vehicle manufacturer, factory branch, distributor, or distributor branch from performing service for reasons of compliance with an order of a court of competent jurisdiction or of warranty under Chapter 17.3 (*§ 59.1–207.9* et seq.) of Title 59.1.

The preceding provisions of this section shall not apply to manufacturers of refined fuels truck tanks or to persons who assemble refined fuels truck tanks or to persons who exclusively manufacture or assemble school buses or school bus parts.

§ 46.2–1572.2. Mediation of disputes.

At any time before a hearing under this article is commenced before the Commissioner, either party to a franchise agreement for the sale or service of passenger cars, pickup trucks or trucks may demand that a dispute be submitted to nonbinding mediation as a condition precedent to the right to a hearing before the Commissioner.

A demand for mediation may be served on the other party and shall be filed with the Commissioner at any time before a hearing is commenced by the Commissioner. The service of the demand for mediation shall, of itself, toll the time required to file requests for hearings and for the time for commencing and completing hearings under this article until mediation is concluded.

A demand for mediation shall be in writing and shall be served upon the other party by certified mail at an address designated in the franchise agreement or in the records of the Department. The demand for mediation shall contain a brief statement of the dispute and the relief sought by the party filing the demand.

Within ten days after the date on which the demand for mediation is served, the Commissioner shall select one mediator from his approved list of mediators or from the lists of hearing officers as set forth in *§ 9–6.14:14.1*. Within twenty-five days of the date of demand, the parties shall meet with the mediator for the purpose of attempting to resolve the dispute. The meeting place shall be within the Commonwealth at a location selected by the mediator. The mediator may extend the date of the meeting for good cause shown by either party or upon the stipulation of both parties.

§ 46.2–1573. Hearings and other remedies.

A. In every case of a hearing before the Commissioner authorized under this article, the Commissioner shall give reasonable notice of each hearing to all interested

parties, and the Commissioner's decision shall be binding on the parties, subject to the rights of judicial review and appeal as provided in Chapter 1.1:1 (*§ 9–6.14:1* et seq.) of Title 9.

B. Hearings before the Commissioner under this article shall commence within ninety days of the request for a hearing and the Commissioner's decision shall be rendered within sixty days from the receipt of the hearing officer's recommendation. Hearings authorized under this article shall be presided over by a hearing officer selected from a list prepared by the Executive Secretary of the Supreme Court of Virginia. On request of the Commissioner, the Executive Secretary will name a hearing officer from the list, selected on a rotation system administered by the Executive Secretary. The hearing officer shall provide recommendations to the Commissioner within ninety days of the conclusion of the hearing.

C. Notwithstanding any contrary provision of this article, the Commissioner shall initiate investigations, conduct hearings, and determine the rights of parties under this article whenever he is provided information by the Motor Vehicle Dealer Board or any other person indicating a possible violation of any provision of this article.

D. For purposes of any matter brought to the Commissioner under subdivisions 3, 4, 5, 6 and 7b of *§ 46.2–1569* with respect to which the Commissioner is to determine whether there is good cause for a proposed action or whether it would be unreasonable under the circumstances, the Commissioner shall consider:

1. The volume of the affected dealer's business in the relevant market area;
2. The nature and extent of the dealer's investment in its business;
3. The adequacy of the dealer's service facilities, equipment, parts, supplies, and personnel;
4. The effect of the proposed action on the community;
5. The extent and quality of the dealer's service under motor vehicle warranties;
6. The dealer's performance under the terms of its franchise;
7. Other economic and geographical factors reasonably associated with the proposed action; and
8. The recommendations, if any, from a three-member panel composed of members of the Board who are franchised dealers not of the same line-make involved in the hearing and who are appointed to the panel by the Commissioner.

With respect to subdivision 6 of this subsection, any performance standard or program for measuring dealership performance that may have a material effect on a dealer, and the application of any such standard or program by a manufacturer or distributor, shall be fair, reasonable, and equitable and, if based upon a survey, shall be based upon a statistically valid sample. Upon the request of any dealer, a manufacturer or distributor shall disclose in writing to the dealer a description of how a performance standard or program is designed and all relevant information used in the application of the performance standard or program to that dealer.

Mrs. BONO. Thank you very much.

Ms. Peterson.

STATEMENT OF FLORENCE PETERSON, GENERAL COUNSEL, AMERICAN ARBITRATION ASSOCIATION, NEW YORK, NY

Ms. PETERSON. Thank you, Madam Chair. My name is Florence Peterson, and I am the General Counsel of the American Arbitration Association. I would like to thank the members of the committee for giving the Association the opportunity to testify on H.R. 534.

The Association is a not for profit educational organization and the largest provider of dispute resolution services in the world. It offers a broad range of dispute resolution services through more than 35 offices in the United States. But the service most in demand from the Association is the administration of arbitrations. I thought after hearing the prior distinguished speakers that what I might be able to most usefully add for this committee is data about what the day-to-day life is for an organization that does administrations of arbitrations as we do.

The Federal Arbitration Act has been successful. Arbitration is widely used for disputes arising in all types of business situations. From the time it was founded in 1926, which was a year after en-

actment of the FAA, the Association has administered about 1.6 million arbitrations. The claims range from hundreds of millions of dollars in dispute to claims for less than $10,000.

About 95 percent of the arbitrations that come to the Association result from pre-dispute arbitration clauses. Our 75 years of experience indicates that at the time a dispute arises people can't agree on anything. We have hearing rooms all over the United States because they can't agree where even to have their arbitration hearing, much less to decide to go forward with an arbitration if it is not in the clause, in the contract clause.

So the choice before this committee is not pre-dispute or post-dispute, it is pre-dispute or litigation, because our experience shows that post-dispute arbitration is something that people won't agree to.

Why are there pre-dispute clauses in hundreds of thousands of contracts now affecting millions of people? Here's why we think it is from our experience: Well, the sheer number of arbitrations over the years has given large numbers of users first-hand experience of the benefits. Usually it is quicker, less expensive and more informal than litigation. Not always, and you will have your bad story and disaster, but that is true in litigation as well.

A second reason is that there are more trained and experienced arbitrators and these people are leaders in the legal and business community and represent all interests. Those are the people making the decisions. The third is the increasing criminal caseloads of the Federal courts that has made resolving civil disputes in court very time consuming and people have to wait too long. And the fourth is that the U.S. courts enforce arbitration clauses and so the process is predictable and reliable.

H.R. 534 would be the first amendment to the FAA, and it would restrict the use of arbitration as a dispute resolution mechanism for this business group, and it appears to be based upon two assumptions: First, that arbitration imposes substantially greater hardships on plaintiffs than those faced in litigation and, second, that litigation is available to all plaintiffs with a legitimate claim.

Arbitration is different from litigation, but if proper procedures are followed it is not second class justice. In fact, researchers have found that employees win more often in arbitration than in court. And unfortunately, litigation is not available to all plaintiffs. The American Bar Association reported that millions of Americans are locked out of court by high legal fees, and most lawyers won't even take a lawsuit worth less than $20,000.

The arbitration as conducted by the Association, and I need to add that many other organizations and individuals who are doing arbitrations as well as the Association, have not only relieved the courts of dealing with millions of disputes over the years—last year we handled 140,000 arbitrations alone. They have given plaintiffs who might otherwise have been precluded from pursuing any remedy an opportunity to have their claim heard. Also, it is important to know that over half of the cases where an arbitration demand is filed settle before there is an actual hearing.

The due process concerns that also may be underlying H.R. 534 and certainly have been raised by people here, can be met by stressing the importance of a fundamentally fair process which can

be had in arbitration. And how is that had? Access to information, independence and impartiality of the arbitrator and the administering organization, availability of a full range of remedies just as would you get in court, a convenient location for the hearing and reasonable fees. And the Association has done just these things in various protocols in alternative dispute resolution.

Government regulatory agencies also have an important role to play in ensuring due process and eliminating overreaching. And of course when there is fraud, duress or unconscionability this is a contract clause like any other, and the courts can allow arbitrations to proceed and amend a particular contract clause, which a court recently did by charging in an employment case the employer all of the fees but letting the arbitration go forward.

I would like to sum up by saying that arbitration is a change of forum, not a change of rights, and general attacks on the adequacy of arbitration procedures rest on a speculative suspicion of arbitration that can be addressed by strengthening the role of already established regulatory agencies, continuing to allow the courts to handle egregious issues ad hoc and encouraging the private development of guidelines. The Association right now is written into dozens of Federal and State statutes by name and we assist Federal and State agencies every day. We continue to offer our availability to assist others in developing appropriate arbitration procedures. Thank you.

[The prepared statement of Ms. Peterson follows:]

PREPARED STATEMENT OF FLORENCE PETERSON, GENERAL COUNSEL, AMERICAN ARBITRATION ASSOCIATION, NEW YORK, NY

Mr. Chairman and Members of the Committee:

My name is Florence M. Peterson and I am the General Counsel of the American Arbitration Association ("AAA"). I would like to thank the members of this Committee for giving the Association the opportunity to testify on H. R. 534.

The AAA is the largest provider of dispute resolution services in the world. As a not-for-profit, public service organization, it offers a broad range of dispute resolution services through more than 35 offices in cities throughout the United States and has cooperative agreements with arbitral institutions in 39 countries around the world. While such services include providing for mediation and other forms of alternative dispute resolution, the service most in demand from the AAA is the administration of arbitration proceedings.

The AAA also promotes ethical standards for dispute resolution. The AAA was instrumental in establishing the Code of Ethics for Arbitrators in Commercial Disputes, the Code of Professional Responsibility for Arbitrators of Labor-Management Disputes, and the Model Standards of Conduct for Mediators.

From the time it was founded in 1926, the year after the enactment of the Federal Arbitration Act, through the end of 1999, the AAA has administered 1,693,431 cases, most of them arbitrations. Virtually all of these cases resulted from pre-dispute arbitration clauses. The AAA's experience in administering arbitration covers domestic and international claims, disputes arising out of collective bargaining agreements and private employment-related matters, and disputes arising in insurance, construction and other industries. These arbitrations range from major commercial disputes involving millions of dollars to claims for less than $10,000, brought by both individuals and businesses. Because the AAA is so heavily involved in the administration of arbitration as well as in education and training, it has a substantial interest in the pending legislation, H. R. 534, Fairness and Voluntary Arbitration Act.

H. R. 534 appears to be based upon the assumption that arbitration is somehow second class justice, or at least that it imposes substantially greater hardships on plaintiffs than those faced in litigation. It also assumes that all plaintiffs with a legitimate claim can obtain competent legal counsel and have their day in court, quickly and inexpensively. This assumption, unfortunately, is not realistic in many jurisdictions. The arbitrations conducted by the AAA, as well as other organizations

and individuals, has relieved the courts of millions of disputes over the years, while giving plaintiffs who might otherwise have been precluded from receiving any remedy, an opportunity to have their claim heard by an impartial decision maker and pursue relief.

It is the experience of the AAA that justice is not diminished in properly conducted arbitration proceedings. Arbitration does not take away the substantive rights of the parties, but provides an alternative forum for resolution of disputes. Usually, arbitration is quicker, less expensive, and more informal than litigation, and allows for an equitable resolution, rather than strict adherence to legal precedence. Congress enacted the Federal Arbitration Act in 1925 to reverse the long-standing judicial hostility to arbitration agreements by American courts, placing arbitration agreements upon the same footing as other contracts. The Federal Arbitration Act sets forth a national policy favoring arbitration. The core expression of this policy is Section 2 of the Act, which provides that a written agreement to arbitrate "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. §2. Federal courts, including the United States Supreme Court, have consistently upheld this national policy.

The federal policy favoring arbitration has had the effect of encouraging the use of arbitration. Pre-dispute arbitration clauses are now included in hundreds of thousands of contracts of all kinds. Some of the elements contributing to the popularity of arbitration that the AAA has identified are:

1. The sheer number of arbitrations, which has given large numbers of users first-hand experience of the benefits of a process that is generally faster and less expensive than litigation, before an unbiased decision maker that they help to select;
2. The increase in the number of trained and experienced arbitrators available, which is in part the result of the growing number of disputes that have gone to arbitration, and in part the result of the emphasis on professional training for arbitrators, which is required by the AAA;
3. The globalization of commercial transactions, which has increased the demand for a neutral forum for resolving international disputes;
4. The increasing criminal caseload of the federal courts, which has made resolving civil disputes in those courts a more time-consuming process; and
5. The consistency of U.S. courts in enforcing the national policy favoring arbitration, especially since the Court overruled *Wilko* v. *Swan,* 346 U.S. 427 (1953), which has given the process increased predictability and reliability.

The demand for arbitration is not limited to parties involved in major commercial transactions and collective bargaining agreements. Over the years, many of the cases administered by the AAA have involved relatively small claims. Historically, the AAA has not kept data that would distinguish business claims from individual claims, but the records of the AAA show that 2,032 claims for amounts under $10,000 were filed in 1998, and 1,937 claims under $10,000 were filed in 1999. In addition, of the total of 140,188 arbitrations administered by the AAA in 1999, 51,622 involved claims arising out of automobile collisions under state "no-fault" statutes. Almost 50,000 of the remaining cases in the AAA's 1999 caseload represent the AAA's involvement in a process mandated by the negotiated settlement of a nationwide class action against a major insurance carrier. Again, many of these cases involved relatively small individual claims.

The AAA would not have been entrusted with the administration of 100,000 claims of individual citizens if those involved—the court overseeing the class action settlement and the state insurance officials responsible for administration of no-fault laws—had not had confidence that arbitration, at least as administered by the AAA with safeguards for a fair process, would provide an appropriate procedure for resolving such claims.

Setting aside the cases entrusted to the AAA by courts or state agencies, the AAA estimates that 90 to 95% of the arbitrations brought to the AAA are submitted to arbitration as a result of pre-dispute clauses in commercial agreements, most of which do not involve individual consumers. The AAA can state with assurance, based on many years of experience that, agreement on any subject being difficult for parties to reach after a dispute has arisen, very few parties will agree to arbitration post-dispute.

Nevertheless, some advocates criticize the inclusion of pre-dispute arbitration clauses in certain types of contracts. And perhaps some concern about arbitration is well placed. For example, an arbitration clause that fails to specify any procedural rules that apply, a method of determining the place of arbitration which is convenient to all parties, or how the expenses of the arbitration are to be paid, could give

rise to an unfair proceeding. These omissions, however, may be supplied by subsequent agreement of the parties or, in the absence of agreement, by the arbitrator or by a supervising court. Furthermore, when circumstances indicate fraud, duress, or unconscionability that would result in the revocation of any contract, courts have refused to allow arbitrations to proceed.

The use of guidelines for particular types of disputes has also proved to be remarkably effective. In 1997, in response to the increasing popularity of arbitration as a means of resolving disputes between businesses and consumers, the AAA convened a National Consumer Disputes Advisory Committee to examine concerns that had been expressed about the arbitration of such disputes and to devise guidelines for handling them that would be acceptable to consumer advocates as well as to businesses that deal with large numbers of consumers. I note that "consumer" in this context refers to natural persons and not to business entities that may play the role of consumer in certain of their transactions. The Advisory Committee consisted of persons affiliated with consumer groups, such as Consumers Union and the American Association of Retired Persons, state government consumer-protection professionals, representatives of businesses that deal directly with consumers, academics, and dispute resolution professionals.

The Advisory Committee, which prepared the Consumer Due Process Protocol, was divided on the question of whether pre-dispute agreements to arbitrate were suitable for transactions between individuals and businesses, under any circumstances. Some commentators feel strongly that such agreements are not appropriate, on the basis of such concerns as the reasonable expectations of consumers and relative bargaining power. Others believe that pre-dispute clauses, even in a consumer context, with appropriate procedural safeguards, can offer consumers a less expensive, more expeditious, less divisive process and provide an effective remedy.

With that important reservation unresolved, the Advisory Committee nevertheless published on April 17, 1998 of *A Due Process Protocol for the Mediation and Arbitration of Consumer Disputes* (the "Consumer Due Process Protocol," a copy of which is appended to this statement as Appendix A). The Protocol stresses the importance of a fundamentally fair process, access to information, independence and impartiality of both the arbitrator and the administering organization, availability of a full range of remedies, a reasonable location for the hearing, and reasonable time limits. The Protocol also states that "Consumer ADR Agreements should make it clear that all parties retain the right to seek relief in a small claims court for disputes or claims within the scope of its jurisdiction." (Principle 5, Appendix A at 3a.)

Subsequently, the AAA adopted a set of arbitration rules specifically tailored to consumer disputes and the principles of the Consumer Due Process Protocol, the AAA's *Arbitration Rules for the Resolution of Consumer-Related Disputes* (the "Consumer Arbitration Rules," a copy of which is appended to this statement as Appendix B). As a matter of internal policy, all consumer disputes filed with the AAA involving claims for less than $10,000 are administered under these rules.

In supporting enforcement of pre-dispute arbitration clauses, subject to appropriate procedural safeguards, the AAA is influenced by the success of another protocol that was drafted under its auspices following the Supreme Court's decision in *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991). The *Due Process Protocol for Statutory Disputes Arising out of the Employment Relationship* was adopted in May 1995 on the recommendation of a group composed of employment attorneys, representatives of labor and management, and dispute resolution professionals. The text of the Employment Protocol may be found on the AAA's website, *www.adr.org*, under Focus Areas-Employment.

The widespread adoption of programs conforming to the safeguards established by that Protocol has made available to millions of workers a range of dispute resolution options—from informal processes such as peer review, through mediation, to binding arbitration. It has been the experience of the companies that most cases are resolved through in-house ADR procedures and relatively few proceed to arbitration. A recent article by the former Director of the ACLU's National Task Force on Civil Liberties in the Workplace examined the results of AAA employment arbitration decisions for the period 1993-1995, just before the adoption of the Employment Due Process Protocol, and concluded that "far more employees win in arbitration than in court, and, overall, employees who take their disputes to arbitration collect more than those who go to court." Lewis Maltby, *Employment Arbitration—Is it really second class justice?*, Dispute Resolution Magazine at 24 (Fall 1999).

Courts can uphold arbitration clauses and still address perceived procedural adequacies. For example, the District of Columbia Circuit recently resolved a case in favor of arbitration in the context of an agreement to arbitrate claims under Title VII of the Civil Rights Act. *Cole* v. *Burns Int'l Sec. Servs.*, 105 F.3d 1465 (D.C. Cir.

1997). In that case, it was unclear who was obliged to pay the arbitrator's fees. The court found that, under Title VII, "employees cannot be *required* to pay for the services of a "judge" in order to pursue their statutory rights." *Id.* at 1468 (emphasis in original). Faced with this proscription in the statute under which the claim was made, and the ambiguity created by the silence of the arbitration clause on the subject of paying for the fees of the arbitrator, the District of Columbia Circuit decided to interpret the arbitration agreement to require the employer to pay all arbitrators' fees, and enforced the arbitration agreement as so interpreted. This same option is open to any court.

In summary, there is nothing inherent in the nature of arbitration that prevents a plaintiff from effectively vindicating his or her rights. General attacks on the adequacy of arbitration procedures rest on a speculative suspicion of arbitration that can be addressed by enacting Congressional guidelines for arbitration in specific situations or by continuing to allow the courts to handle these issues ad hoc, based on the facts of a particular case.

Mrs. BONO. Thank you very much.

Mr. Turnauer.

STATEMENT OF JERRY TURNAUER, PRESIDENT, BAYSHORE STERLING TRUCK, NEW CASTLE, DE

Mr. TURNAUER. Thank you Madam Chair. Good morning. My name is Jerry Turnauer. I am a truck dealer in Delaware, franchised for Ford, Mitsubishi-Fuso and Sterling trucks. I am a member of the American Truck Dealers Association. I thank you for holding this hearing and appreciate the opportunity to explain why Congress must pass H.R. 534.

It is not easy to come here today, but I hope you will find my personal experience with mandatory binding arbitration relevant to the bill. I want to emphasize this debate for me is not about arbitration. The debate is really about those two words, "mandatory binding," tied to arbitration clauses. The benefits of arbitration are the same whether you arrive there voluntarily or are forced there. So please keep the focus on those two words, "mandatory binding."

Mandatory obviously means no freedom of choice, forced, which in itself to me is almost un-American. Binding suggests to me that arbitrators have to be divine, as they never err because they are beyond any kind of review or appeal process. This is virtually impossible and unrealistic in today's specialized and fast paced business world.

Like most dealers I have built my business over the years through good times and bad. My family lifetime net worth is my dealership. I am proud of the business I have built, the employment we provide and our citizenship in the community. Like the small business people in your community, I just want to run my business and be treated fairly.

Forty-nine States have statutes that attempt to level the huge disparity and bargaining power between franchise automotive dealers and the multinational corporations of the manufacturers, but a loophole in the Federal Arbitration Act resulting from a Supreme Court decision opened the door for manufacturers to include mandatory binding arbitration in dealer agreements, permitting them to circumvent or minimize the very state laws legislated to level the playing field between us.

Manufacturers hold all the cards and offer their franchise contracts on a "take it or leave it" basis with no changes permitted. In fact, the process is so one-sided that any time a manufacturer can and does add an addendum simply by mailing it out, it be-

comes part of the contract without any agreement or acceptance by the dealer. Because of the one-sidedness of vehicle franchise contracts they are called contracts of adhesion by legal people. It is my understanding the Federal Arbitration Act was never intended to apply to "take it or leave it" contracts.

As a Ford truck dealer since 1976, I became a Sterling dealer when Ford sold their heavy truck business in 1997 to Freightliner, now a DaimlerChrysler company. Freightliner renamed the line of trucks Sterling. To become Sterling dealers Ford truck dealers had to sign a franchise agreement with Sterling that included mandatory binding arbitration. Now in the midst of a dispute with Sterling, I have come to understand firsthand the real reasons for the manufacturers' devotion to mandatory binding arbitration.

Our dispute potentially affects the economic survival of many of us. Sterling introduced a new model truck named Acterra that required dealers to sign a separate new franchise in order to sell the vehicle. The practice of creating a franchise within a franchise raises a fundamental fairness issue and is prohibited or restricted by law in a number of States. The Acterra franchise demands that the dealer capitalize and invest in an independent business entity, separate financially and in staffing from any other dealership you now operate, have exclusive facility of minimum size and acreage, and operate 24 hours a day 7 days a week in virtually all but the very smallest markets. This means tremendous additional overhead expenses. These requirements are not part of our original Sterling franchise.

Many dealers believe these demands raise a real threat of economic suicide. Because of this suicide threat and the fact that as existing Sterling dealers we believe we are entitled to any new model Sterling truck, we filed a demand for arbitration for injunctive relief from the Acterra franchise.

I organized a group of 43 Sterling dealers to join me in the demand for arbitration filed in January this year. Since our Sterling franchise agreements and the single issue in dispute are both identical, we sought a single proceeding with me as the lead claimant and the other dealers as additional claimants. Sterling challenged the single filing procedure with the American Arbitration Association. But after hearing arguments of both sides the American Arbitration Association accepted our single filing and ruled that we pay a single filing fee of $2,000.

Sterling objected strenuously to both the single filing procedure as well as the fact that we only paid one fee. After losing the procedural challenge with the American Arbitration Association, Sterling filed a Federal lawsuit to compel each dealer to file separately and each pay a $2,000 fee. On May 23, Federal Judge Gwin, Northern District of Ohio, dismissed Sterling's appeal and ruled that the arbitrator is legally empowered to make the procedural determination.

Mrs. BONO. Mr. Turnauer, can you come close to wrapping up in about 15 seconds, please.

Mr. TURNAUER. He noted, in quotes, "Sterling truck greatly overstates the practical challenges of resolving this dispute in a single arbitration proceeding."

The procedural argument by Sterling has frustrated our attempts for quick and economical solution. This experience suggests to me the manufacturer is not concerned about conserving judicial resources nor saving time and money for both parties. Conversely, it seems their primary aim is the opposite, to delay resolution, demoralize us by wasting our time, our money.

[The prepared statement of Mr. Turnauer follows:]

PREPARED STATEMENT OF JERRY TURNAUER, PRESIDENT, BAYSHORE STERLING TRUCK, NEW CASTLE, DE

Chairman Gekas and Members of the Subcommittee, my name is Jerry Turnauer and I am a truck dealer in Delaware franchised for Ford light and medium trucks, Mitsubishi-Fuso medium trucks and Sterling heavy trucks. I am a member of the American Truck Dealers Association. I thank you for holding this hearing and appreciate the opportunity to explain why Congress must pass H.R. 534, the Fairness and Voluntary Arbitration Act sponsored by Representative Bono and cosponsored by over 180 other House Members. It is not easy to come here today, but I hope hearing my personal experience will confirm that mandatory binding arbitration as imposed unilaterally by manufacturers in vehicle franchise agreements is inherently unfair and an abuse of their enormous economic leverage over any individual dealer or dealers.

I want to emphasize that arbitration is *not the heart* of this debate. Those opposed to H.R. 534 and S.1020 typically shift the debate to the benefits of arbitration. I agree that arbitration has many benefits as a useful and practical ALTERNATIVE dispute resolution method, but by no means should it be the ONLY method of resolving any and all disputes. This debate is really about the two words—*MANDATORY and BINDING*—tied to arbitration clauses in many motor vehicle franchise contracts by the manufacturer.

Mandatory, obviously, means no freedom of choice, forced, which in itself is almost un-American. The Binding word suggests to me that arbitrators have to be divine as they never err since a review or appeal process is virtually impossible. This is simply unrealistic in today's highly specialized, complex fast paced business world. Thus, the very benefits of arbitration are diminished, as well as the substantive legal rights afforded to automobile and truck dealers throughout the country.

As many in the auto retailing business, I've built my business over the years through good economic times and bad. My family's lifetime net worth is my dealership and I am proud of the business I have built, the employment we provide, and our citizenship in the community. Like the small businessmen in your communities, I just want to run my business and be treated fairly.

The situation that brings me before you is rather unique, since under state law dealers in 49 states have statutes that attempt to level the huge disparity in bargaining power between small businesses and the multinational corporations of the manufacturers. But a loophole in the Federal Arbitration Act (FAA) resulting from a Supreme Court decision opened the door for manufacturers to include mandatory binding arbitration in dealer agreements in order to circumvent or minimize the state laws and processes legislated to level the playing field between us.

Manufacturers hold all the cards and offer their franchise contracts on a "take it or leave it" basis with no changes permitted. In fact, the process is so one-sided, at any time the manufacturer can *and does* simply mail out an addendum that becomes part of the contract without any agreement or acceptance by the dealer. State motor vehicle franchise laws offer dealers substantive and procedural provisions to counterbalance these monopolistic terms of our franchises. Because of their one-sidedness vehicle franchise contracts are called "contracts of adhesion" by legal people. It's my understanding the FAA was never intended to apply to "take it or leave it" contracts. Congress must take action to stop this abusive practice and allow us unobstructed access to our state laws.

As a Ford truck dealer since 1976, I became a Sterling dealer when Ford sold their heavy truck business in 1997 to the Freightliner Corporation, now a DaimlerChrysler company. Freightliner renamed this line of trucks "Sterling." To become Sterling dealers, former Ford truck dealers had to sign a franchise agreement with Sterling that included mandatory binding arbitration of disputes. Now involved in the midst of a Sterling dispute, I have come to understand first hand the real reason for the manufacturer's devotion to mandatory binding arbitration.

The dispute we're involved in with Sterling potentially affects the economic survival of many of us. Sterling introduced a new model Sterling truck named Acterra

and required that dealers sign a separate new franchise agreement in order to sell the vehicle. The practice of creating a "franchise within a franchise," raises a fundamental fairness issue and is prohibited or restricted by law in a number of states. Acterra demands that the dealer establish an independent business entity, separate financially and in staffing from any existing dealership now operated, have exclusive facility of minimum area and acreage, and operate 7days and 24 hours a day in virtually all but the very smallest markets.

The Sterling Acterra franchise thus places many more onerous financial demands on us than the original Sterling agreement. In the opinion of many dealers these demands pose a real threat of economic suicide. Because of this suicide threat and the fact that, as existing Sterling dealers, we believe we are entitled to any new model Sterling truck, we dealers filed a Demand for Arbitration for injunctive relief from the Acterra franchise.

I organized a group of 43 Sterling dealers to join me in the Demand for Arbitration filed January 20, 2000. Since our franchise agreements and the single issue in dispute are both identical, we sought a single proceeding, with me as the lead claimant and the other dealers named as additional claimants. After some preliminary discussion and controversy between our attorneys and Sterling's attorneys about the single filing procedure, the American Arbitration Association (AAA) accepted our single filing and ruled, correspondingly, for us to pay a single filing fee of $2000.

Sterling objected strenuously to both the single filing procedure and payment of one fee. After losing this procedural challenge at the AAA they filed a Federal lawsuit seeking to compel each dealer to file a separate proceeding and have each pay a separate filing fee of $2000. On May 23 Federal Judge Gwin, Northern District of Ohio, dismissed Sterling's appeal and ruled that the arbitrator is legally empowered to make the procedural determination.

In his opinion, Judge Gwin noted that "Sterling Truck greatly overstates the practical challenges of resolving this dispute in a single arbitration proceeding." The Judge noted the irony of Sterling's desire to have as many as forty-two different arbitrations, when the arbitration is intended to be speedy and efficient.

Although manufacturers often try to justify forced arbitration as a faster, less expensive system for resolving disputes, the procedural argument by Sterling has frustrated our attempts for a quick and economical resolution of the dispute, which calls into question their real aim with mandatory binding arbitration. This experience suggests to me the manufacturer is not primarily concerned about conserving judicial resources, nor saving time and money for both parties; conversely, it seems their primary aim is the opposite, namely; to delay resolution in order to demoralize us by wasting our time and money. We are approaching 5 months since our filing of January 20, 2000 and are not within sight of a schedule date for the arbitration due to Sterling's delaying tactics.

I'd also like to mention that mandatory binding arbitration is not the panacea it is sometimes made out to be. For instance, in our dispute many dealers throughout the country would have preferred to utilize their state administrative forums to resolve the matter within the provisions of their state law. But mandatory binding arbitration precludes dealers from utilizing these state established forums in the 33 states that provide an inexpensive and expedient forum for resolution. The delays with our case have doubled our legal expenses so far and could triple it or more before it's concluded.

Although mandatory binding arbitration is touted by the manufacturer as a preferable dispute resolution method because of its "speed and efficiency," this experience has taught me that arbitration is not necessarily speedy and efficient, but can be manipulated by the stronger party. I would argue that mandatory binding arbitration is even inferior to the worst type of litigation, because with litigation the parties are afforded protections under state and federal laws that are easily dismissed in mandatory binding arbitration.

The solution is voluntary arbitration. Where arbitration is appropriate, as sensible financially savvy business-people, we'll *voluntarily* opt for it without having it forced down our throats for every foreseeable and unforeseeable dispute regardless of how minor or major the issue and its consequences.

I speak from experience, and can speak for the many automobile and truck dealers who are too intimidated to step forward, but are learning the hard way that mandatory and binding arbitration is neither fair nor fast. The manufacturer has great control of each dealer's business and decides: when he/she receives products and parts, is allocated hot or short supply products, receives warranty payments and incentive payments and the like. The manufacturer should not also control our legal rights. I simply cannot believe Congress ever intended to allow a stronger party to force a weaker party to waive their rights in advance, particularly when

a whole body of state law has been passed to govern the dealer-manufacturer relationship.

Even though I have my life's assets at risk, I have more consideration under the law if I get a $25 parking ticket than I am afforded with the net worth of my life's work. I have to say this lack of due process should concern members of Congress particularly since the dealer never voluntarily agreed to resolve disputes in this manner.

It is my understanding that only Congress can remedy this unfair situation since the courts have held that the Federal Arbitration Act prevents states from stopping this type of abuse. I believe that a number of states have enacted laws that prohibit this practice and other states even have constitutional provisions that protect a citizen's right to pursue state law remedies. Unfortunately, the FAA makes such state laws unenforceable. The reason I am here today, is to try and correct this inequity that allows manufacturers to circumvent state law.

This inequity will never be rectified without Congressional action. That is why enactment of H.R. 534 is so critical. On behalf of auto and truck dealers throughout the nation, we respectfully urge you to close this loophole to restore the rights we are duly entitled to under state law. The continued existence of many small business dealers depends on it.

Thank you.

Mrs. BONO. Thank you. We need to move on to the next witness if we can. I know the 5 minutes goes by very quickly. Sometimes it goes by very slowly. Trust me.

Mr. Wootton, please.

STATEMENT OF JAMES WOOTTON, PRESIDENT, U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, WASHINGTON, DC

Mr. WOOTTON. Thank you, Madam Chairwoman. I am here today testifying as president of the U.S. Chamber Institute for Legal Reform and on behalf of the U.S. Chamber of Commerce, and I want to start by saying that I want to join Senator Sessions in saying that the Chamber does not take a position as to the dispute between the manufacturers and dealers, both of whom are represented on our board. But we believe that this bill has two main flaws, and both of which would be sufficient to recommend it not being passed.

First and most important, H.R. 534 runs counter to the basic principle that parties' private contractual agreements should be enforceable, and this is a principle that the Congress has historically recognized and should depart from only with a strong showing.

Secondly, H.R. 534 runs counter to the long-standing, uniform view of Congress, the executive branch, and the courts that alternative dispute resolution in general, and arbitration in particular, are important and encouraged means for parties to resolve their disputes.

H.R. 534 would undermine clear congressional intent to support the use of ADR. It would exempt one type of contract from the provisions of the FAA, and as Senator Feingold, Mr. Nadler and others have noted, it would lead every other industry to worry that their arbitration clauses might be next.

Further, H.R. 534 would exacerbate problems in the incredibly overburdened civil legal system and harm not only the parties who have agreed to binding arbitration but also everyone who chose not to agree to arbitration, who will find the courts even more overwhelmed.

Clearing up a point of terminological confusion will help show why this bill is problematic. People routinely use the dichotomy "voluntary" versus "mandatory," or "compulsory," to describe arbi-

tration, and this bill itself is cast in that language. But in fact it is not relevant here since H.R. 534 addresses only a subset of voluntary arbitration. Mandatory arbitration is arbitration that is required without the consent of the parties either by statute or court rule. Voluntary arbitration on the other hand is arbitration that parties agree to engage in either at the time a dispute arises or much more commonly at the time they enter into a contract.

This bill would not merely lead to questions about the future enforceability of any arbitration provision, more fundamentally it would lead to real questions about whether parties would be able to presume that any of their contracts in the future will be enforceable.

Congress should insist on an extremely high showing of need before venturing down such a problematic path. Consistent with Mr. Hebe's testimony, we know of no such showing at this point. Supporters of H.R. 534 focus on the fact that many arbitration provisions are contained in contracts drafted by one party and presented to the other to accept or reject as a whole. But while this is sometimes true, it is no justification for the bill. Classic principles of contract law allow a party to repudiate a contract whether it be a contract of adhesion or otherwise for fraud, unconscionability or various other factors. And as Mr. Fondren noted, the FAA itself specifically recognizes this right. This is the main point. The supporters of H.R. 534 are asking Congress to resolve the ultimate issue, which is that contracts of adhesion exist between auto dealers and the manufacturers. This is an issue that courts are able and competent to resolve.

The final question I'd like to address is whether or not this is violation of Federalism. Federalism arguments that arbitration and the FAA subvert State legislative policies about the relationship between automobile manufacturers and dealers fail for three reasons. One, it is true that arbitrators will take on the issue of the application of State law based on their view of the fairness of the situation, but it is also true that they are trying to resolve the matter fairly.

Secondly, the excessive litigation that we think H.R. 534 will ultimately lead to because of the slippery slope it represents will put burdens on everyone. And finally, preemptive laws have a similar effect on all State law and it is clearly within the power of Congress to preempt those laws through its Constitutional authority to regulate interstate commerce. For these reasons and the others, the U.S. Chamber of Commerce strongly opposes this legislation and we would be glad to answer questions.

[The prepared statement of Mr. Wootton follows:]

PREPARED STATEMENT OF JAMES WOOTTON, PRESIDENT, U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, WASHINGTON, DC

Good morning. I am Jim Wootton, President of the U.S. Chamber Institute for Legal Reform, an affiliate of the U.S. Chamber of Commerce. The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and professional organizations of every size, in every business sector, and in every region of the country. The central mission of the Chamber is to represent the interests of its members before Congress, the Administration, the independent agencies of the federal government, and the courts. The mission of the U.S. Chamber Institute for Legal Reform is to reform the nation's justice system to make it more predictable, fairer and more efficient while maintaining access to our

courts for legitimate lawsuits. On behalf of the U.S. Chamber Institute for Legal Reform and the U.S. Chamber of Commerce, I appreciate the opportunity to testify before the Subcommittee to express our opposition to H.R. 534.

H.R. 534 is entitled the "Fairness and Voluntary Arbitration Act." But that is just the problem—it is *not* fair, and it is *not* voluntary. Instead, H.R. 534 is a license for a party to a contract to violate, at will, a contractual provision requiring disputes under that contract to be arbitrated. The bill thus has two main flaws, each of which, in our view, is sufficient to mandate that it should not become law.

First and most important, H.R. 534 runs counter to the basic principle that parties' private contractual agreements should be enforceable. Congress has historically recognized the vital principle of the sanctity of contracts. By passing this bill not only would Congress undermine voluntarily agreed upon contracts, it would be ignoring the very axiom that, with narrow exceptions, parties should be allowed to enter into and be bound by the agreements they choose.

Second, H.R. 534 runs counter to the longstanding, uniform view of Congress, the executive branch, and the courts that Alternative Dispute Resolution (ADR) in general, and arbitration in particular, are important and encouraged means for parties to resolve their disputes. H.R. 534 would undermine clear congressional intent to support the use of ADR. It would exempt one type of contract from the provisions of the Federal Arbitration Act (FAA), 9 U.S.C. §§ 1–16, leading every other industry to worry that their contracts might be next. Furthermore, H.R. 534 would exacerbate problems in the incredibly overburdened civil legal system, and harm not only the parties who have agreed to binding arbitration clauses but also everyone who chose *not* to agree to arbitration, who will find the courts even more overwhelmed.

1. H.R. 534 undermines the fundamental principle that parties should be free to contract as they will.

While the Chamber is strongly in favor of arbitration (see section 2, *infra*), there is a much more fundamental problem with H.R. 534. By denying to parties the *ability* to include effective binding arbitration provisions in their contracts, H.R. 534 is a direct attack on perhaps the most fundamental principle of our commercial law, that parties should be allowed to enter the binding contracts they choose.[1] H.R. 534 has little to do with protecting the little guy from the imagined evils of arbitration, and *everything* to do with allowing a party to a contract to ignore certain terms of that contract at will. Parties that are signatories to a writing purporting to be a contract generally should be bound by that writing and all its terms. To allow otherwise would countermand our collective interest in promoting the finality and certainty of contracts. Down this slippery slope lies increasing uncertainty from which only the plaintiffs' trial bar will prosper.

Clearing up a point of terminological confusion will help to show why this bill is so problematic. People routinely use the dichotomy "voluntary" versus "mandatory" (or "compulsory") to describe arbitration, and this bill itself is cast in that language. But in fact it is not relevant here, since H.R. 534 addresses only a subset of *voluntary* arbitration. Mandatory arbitration is arbitration that is required without the consent of the parties, either by statute or court rule.[2] Voluntary arbitration, on the other hand, is arbitration that parties agree to engage in, either at the time a dispute arises or, much more commonly, at the time they enter into a contract.[3] H.R.

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[1] That Section 3 of H.R. 534 limits the bills applicability to contracts "entered into, amended, altered, modified, renewed, or extended after the date of the enactment" of the bill does not render the bill any more defensible. While this provision allows the bill to avoid easy attack as retroactive legislation, H.R. 534 still subverts existing negotiated contracts, which absent this legislation would be renewable. More fundamentally, H.R. 534 forbids future contracts from including binding arbitration provisions, a severe limit on the freedom of parties to contract as they will.

[2] *See* Cooley & Lubet, ARBITRATION ADVOCACY 10 (NITA 1997). Congress has mandated forms of arbitration under certain statutes, such as the Railway Labor Act, 45 U.S.C. § 153, and certain types of court-annexed ADR prior to litigation. See 28 U.S.C. §§ 651–658.

[3] As the Regional Vice President of the American Arbitration Association explained while testifying before the predecessor to this subcommittee in 1992, by the time a dispute actually arises one party or other will frequently change its mind and decide that it would rather go to court—usually as a means of delaying paying the money it owes. *See Arbitration of Sales and Service Contract Disputes: Hearings on H.R. 3122 Before the Subcomm. on Economic and Commercial Law of the House Comm. on the Judiciary*, 102d Cong., 2d Sess. 64 (1992) (Serial No. 57) (statement of Garylee Cox). (As I discuss later, see infra at 6–7 & n.15, this may also be a result of the desire of that party's *lawyer* to go to court.) While the courts will *enforce* such an arbitration agreement over the party's objection, it still remains "voluntary" arbitration—the voluntary arbitration that party agreed to when it signed the contract that included an arbitration provision.

534 thus addresses voluntary arbitration. It allows sophisticated businesses to renege on their voluntary *contractual* arbitration agreements, without any penalty.

Arbitration has distinct advantages, that in many cases make it a highly desirable process.[4] It also has specific disadvantages, that occasionally make it a less appropriate means by which to settle a dispute.[5] But these advantages and disadvantages are, in the end, not the point. Two parties should be allowed to decide for themselves whether voluntarily to submit their disputes to binding arbitration.[6] By undermining 75 years of consistent congressional, administrative, and judicial support for voluntary arbitration, Congress would subvert settled expectations about the availability of arbitration for this type of dispute. This bill would not merely lead to questions about the future enforceability of any arbitration provision; more fundamentally, it would lead to real questions about whether parties will be able to presume that *any* of their contracts will, in the future, be enforceable. Congress should insist on an extremely high showing of need before venturing down such a problematic path.

Supporters of H.R. 534 focus on the fact that many arbitration provisions are contained in contracts drafted by one party, and presented to the other to accept or reject as a whole. But while this is sometimes true, it is no justification for the bill. Classic principles of contract law allow a party to repudiate a contract—whether it be a contract of adhesion or otherwise—for fraud, unconscionability or various other factors, and the FAA specifically recognizes this right. But unless a contract including an arbitration provision is unconscionable, that arbitration provision should be enforced, just as other provisions of the contract are enforced. One party should not be free to parse out those elements of the contract that, in retrospect, appear to favor the other. As one commentator reminded us very recently, "Courts enforce adhesive contracts. Such contracts are not contrary to public policy."[7]

Given the realities of modern business in this litigious environment, detailed contracts are an unfortunate necessity. Only in instances of compelling need, however, do courts—or should a legislature—set aside or dictate contractual provisions. A party who disfavors arbitration can determine for itself how upsetting the other party's insistence on arbitration is, and weigh that factor in deciding whether to enter the contract that includes the arbitration provision. A statutory provision which revokes the ability of that other party to insist on arbitration *ex post*, however, would substitute the judgment of the legislature for the decisions of the parties.

2. Congress's clear, longstanding support for arbitration should not be reversed.

In language remarkably similar to that one hears today, the 68th Congress passed the FAA to give "parties weary of the ever-increasing 'costliness and delays of litigation'" another option.[8] The FAA embodies our "national policy favoring arbitration."[9] But arbitration was by no means a new idea in 1925. In an article in the February, 2000 issue of the *Dispute Resolution Journal*, Judge Marjorie Rendell of the Third Circuit in Philadelphia quotes at length from George Washington's will. The father of this nation mandated, in language Judge Rendell correctly describes as eerily "prescient" to modern ADR provisions, that any dispute arising under that will should be decided by three impartial arbitrators, two chosen by the parties and the third chosen by the first two.[10]

Our nation is in the midst of a litigation explosion. While there is no question that every American deserves to have legitimate grievances heard, the civil legal system is suffering—becoming more inefficient, less timely and more unpredictable than ever before. The old adage that "justice delayed is justice denied" is a concept

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[4] The speed and affordability of arbitration are perhaps its most discussed benefits, but there are others as well. For example, the control parties have over the process of arbitration, the ability to have an "expert" decisionmaker rather than a generalist judge, and the ability of an arbitrator to craft remedies specific to a dispute are all distinct advantages of arbitration over litigation. See section 2, *infra*.

[5] For example, because there are only very limited rights of appeal there is less quality control in arbitration—though since the parties choose the arbitrators this is often not really an issue. In some circumstances the power of courts to compel witnesses, or the litigation discovery process more generally, also leads the parties to prefer litigation.

[6] The FAA's "central purpose" is "to ensure that private agreements to arbitrate are enforced according to their terms." *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53–54 (1995) (quotation omitted).

[7] Orenstein, *Mandatory Arbitration: Alive and Well or Withering on the Vine?* 54–Aug DISPUTE RESOL. J. 57, 59 (1999). It is a commonplace that no contract is ever entered into by two people with exactly equal bargaining power.

[8] *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213, 220 (1985), quoting H.R. Rep. No. 96, 68th Cong., 1st Sess. 2 (1924).

[9] *Southland Corp.* v. *Keating*, 465 U.S. 1, 10 (1984).

[10] Rendell, ADR *Versus Litigation*, 55–Feb. Disp. Resol. J. 69, 69 (2000).

that dates back to the Magna Carta.[11] Fortunately, however, we need not make the impossible choice between an increasingly inefficient civil justice system and the denial of a fair hearing for those who require it. The use of ADR to resolve conflicts can alleviate some of the negative effects of the current litigation explosion. Recognizing this, many industries have begun to include clauses in their contracts requiring the parties to submit to binding arbitration should a dispute arise, a move encouraged by the U.S. Chamber of Commerce's Board of Directors in a resolution passed in 1986, which supported the use of ADR.[12]

Under the FAA, a contractual agreement to arbitrate is simply treated as any other enforceable contractual arrangement. In other words, under the FAA *arbitration provisions just cannot be "singl[ed] out * * * for suspect status."*[13] Thus, "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening" the FAA.[14] These classic exceptions to the enforcement of any contract serve to protect against abuse. But provisions mandating arbitration are no *more* likely to be abusive than any other—in fact, arguably less so, given the uniform federal support for arbitration over the past three quarters of a century.

It is precisely these contractually negotiated arbitration provisions, critically necessary to help staunch the nation's rush to litigation, that H.R. 534 would subvert. ADR typically is quicker, cheaper, and more predictable than civil litigation, and is much less easily abused in this litigation-as-lottery age than the lawsuits favored by the plaintiffs' bar.[15] Far from being inherently unfair, as the plaintiffs' bar sometimes asserts, arbitration provisions provide an invaluable alternative to having one's claim heard in court. Parties to a dispute may have a full and fair hearing of their grievances by presenting witnesses, evidence and case facts to a neutral third party in much the same manner as they would in a court of law. Unburdened by the often rigid rules of civil procedure, parties in an arbitration are also free, in many cases, to customize the proceedings to address specific needs and devise the best method to resolve their dispute.

Furthermore, federalism arguments that arbitration subverts state legislative policies about the relationship between, for example, automobile manufacturers and their dealers, fail for at least three reasons. First, it is simplistic to claim that arbitrators will ignore state statutory policies. While it is true that arbitrators frequently are—*by agreement of the parties*—free to balance the equities of a particular case so as to craft an appropriate remedy, it does not follow that arbitrators will always ignore certain statutory provisions. Rather, as would be expected in this more informal, agreed upon procedure, those statutes will be followed to the extent the selected arbitrators find them to be applicable given the details of the situation.

Second, the excessive litigation created by H.R. 534 will impose costs broadly on the national economy—costs borne by individual consumers, employees and shareholders. These costs will be avoided by not undermining the FAA's broad support for arbitration. For businesses to operate efficiently in today's national (and increasingly international) economy there need to be uniform rules in matters involving

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[11] *See* 1 Holdsworth, A HISTORY OF ENGLISH LAW 57–58 (3rd ed. 1922).

[12] Binding arbitration clauses are currently used in a wide range of contracts, including contracts for employment, car and home purchase, service, credit, insurance, and other financial services. In all of these contexts, arbitration provides the parties with a way to avoid the vagaries of our current jackpot legal system by agreeing to submit to a contractually defined method of dispute resolution.

[13] *Doctors Associates, Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996) (citation omitted) (emphasis added). Since "arbitration under the Act is a matter of consent, not coercion," *Volt Info. Sciences, Inc.* v. *Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989), "'an arbitration agreement [must] be placed upon the same footing as other contracts, where it belongs.'" *Southland*, 465 U.S. 1, 15–16, quoting H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924); see also *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 281 (1995).

[14] *Casarotto*, 517 U.S. at 686. As the Fourth Circuit said recently, "singl[ing] out arbitration agreements in standardized contracts [is], in effect, [to] declare their very formation to be unconscionable." *Saturn Distrib. Corp.* v. *Williams*, 905 F.2d 719, 726 (4th Cir. 1990). Barring enforceable arbitration agreements, despite having "no general contract law restricting nonnegotiable provisions in standardized contracts' evinces a "singular hostility" to arbitration fundamentally at odds with the theory of the FAA. *Ibid.*

[15] Mandatory arbitration clauses make it virtually impossible for some unscrupulous plaintiffs' trial lawyers to engage in many of the abuses that currently mar our civil justice system. Speculative litigation, forum-shopping, and exorbitant legal fees are easily eliminated if parties to a dispute agreed to binding arbitration rather than go to court. *See* Rogers, *Self-Interested Critics Only Spinning Truth About a Process that has been Approved by Congress*, 5–1 DISP. RES. MAG. 5, 6 (1998) (While "there are those who oppose arbitration on mistaken but principled grounds * * * there can be no question that among those who criticize arbitration are advocates who benefit from the unnecessary costs of the civil trial system [and its occasional allowance for] legalized blackmail.")

interstate commerce.[16] As the U.S. Chamber of Commerce pointed out in the *amicus curiae* brief it recently submitted in the *Geier* case, "[t]he general economic interests of the Nation are increasingly being sacrificed on the altar of the parochial interests of particular states, as declared by local state judges and lay juries.[17] Undermining the preemptive effect of the FAA would continue that negative trend.

Finally, all federally preemptive laws have a similar effect on state law, and Congress clearly has, and exercises, the authority to preempt state law under the Constitution's Commerce Clause. The legal relationships between automobile manufacturers and their dealers certainly have "a substantial relation to interstate commerce."[18]

If industries are forced to litigate every dispute that arises out of routine business contracts, almost all parties will suffer. Businesses will spend more of their resources preventing and defending against litigation as opposed to developing and improving products and services; consumers will spend more in transaction costs for routine business matters; and, on the whole, society will bear the cost of managing a burgeoning civil justice system. From a broader standpoint, the availability of arbitration has provided some much needed relief from the congestion of cases currently clogging the civil justice system. If H.R. 534 is passed, the U.S. Chamber believes it would be the first step down a slippery slope to undermining the intent and effect of the FAA in many areas, not just between automobile manufacturers and their dealers. This could result in thousands of cases that would have otherwise been resolved through arbitration cascading into the federal and state courts.

For these reasons, the U.S. Chamber of Commerce and the U.S. Chamber Institute for Legal Reform oppose this legislation. Mr. Chairman, thank you again for the opportunity to testify today. I would be happy to respond to any questions the members of the Subcommittee may have.

Mrs. BONO. Thank you. I am going to begin with my questions. Ms. Peterson, in your testimony, in your written testimony as well, I think something that I was thinking about, Mr. Turnauer ultimately brought up as well. The heart of this bill is simply again the words "voluntary" rather than "mandatory." you don't take a position on that. What is AAA's position on forced arbitration? Do you support it, forced arbitration, yes or no?

Ms. PETERSON. I support contracts between business people.

Mrs. BONO. But forced. Forced arbitration or mandatory. It is the crux of the issue here. Your testimony was wonderful. It was great. The virtues of arbitration and all but the heart of the issue is mandatory, voluntary.

Ms. PETERSON. What I am saying is a pre-dispute clause is the only way to get people to arbitrate. If your perception or the perception of others here is that that then makes it forced because these contracts, the particular people that we are dealing with here don't have the bargaining power, which is what I have been hearing, I think you—everyone has to realize that this is true or alleged in many business situations.

So what you are doing with this bill is not dropping a pebble in a pond; you are dropping a two-ton boulder, because this argument will come up over and over again that just as the other terms in the contracts between franchisees and franchisers——

Mrs. BONO. I am sorry, can I cut you off. I have 5 minutes. I just needed a simple answer to a simple question. Mr. Fondren if I could. What percentage of mandatory binding arbitration clauses between dealerships and manufacturers are contained in side agreements as opposed to the franchise agreement itself?

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[16] *See* Conrad & Wootton, *One Economy Indivisible*, LEGAL TIMES 19 (Sep. 13, 1999).

[17] Brief amicus curiae for the *U.S. Chamber of Commerce at 20, Geier* v. *American Honda Motor Co.*_____U.S_____, 2000 WL 645536 (U.S. May 22, 2000) (No. 98–1811).

[18] *United States* v. *Lopez*, 514 U.S. 549, 559 (1995).

Mr. FONDREN. Mrs. Bono, I cannot give you a specific numerical figure. I do know that over time and particularly of late that a number of manufacturers are including arbitration agreements, not in the franchise agreement itself but in side agreements that they make in incentive programs, in property arrangement agreements and things of that sort. The arbitration clauses that I have seen in those side agreements, however, do apply to the main franchise and to the provisions of that franchise such as I have described.

Mrs. BONO. All right. If fewer than 10 percent of dealerships are subject to mandatory binding arbitration agreements, why is Federal legislation necessary?

Mr. FONDREN. I disagree with that number for one, Mrs. Bono. The manufacturers have furnished the Congress with a document which they call a work in progress. I agree it is a work in progress. It shows about 10 percent of the dealers. I think to the best of my knowledge at least a third of the dealers or nearly a third of the dealers in the country are now covered. And absent your legislation and that of Senator Grassley and Senator Feingold in the Senate, there would be many, many more today than we already have. If one dealer who is covered by mandatory binding arbitration loses the property rights that they have under State law, then I think that is one too many. But I think that the number is far greater than that indicated by the manufacturers and they admit that it is a work in progress.

Mrs. BONO. Thank you. Has the NADA made any efforts to resolve this directly on their own with the manufacturers?

Mr. FONDREN. I don't know that there have been direct negotiations with manufacturers with respect to this clause. We have attempted at the State level, numerous States have attempted to discuss the possibility of eliminating the clause. Many of us have passed State laws that require voluntary arbitration after dispute arises, that very typically is ignored by the manufacturer and they will insist on mandatory binding arbitration because they want to circumvent State law. That is what mandatory binding arbitration is really all about.

Mrs. BONO. Thank you. My yellow light is on. We are going to have a vote on here, so in the interest of time I am going to go ahead and let Mr. Nadler ask his questions. Then we will adjourn for a vote.

Mr. NADLER. I have a number of questions, so see if you can keep your answers brief. First of all, I forget who is who. Who is here for the car dealers?

Mr. FONDREN. I represent——

Mr. NADLER. Mr. Fondren. Do car dealers and service centers ever insert binding arbitration clauses in their contracts with consumers?

Mr. FONDREN. Yes, they do.

Mr. NADLER. They do sometimes.

Mr. FONDREN. Yes, they do. In certain jurisdictions they do.

Mr. NADLER. Who is the manufacturers and the dealers? Mr. Hebe. You said, I think, that these are not contracts of adhesion. Are you aware—are any of you representing the dealers, the dealers and manufacturers, are any of you aware of a dealer who refused to sign a renewal franchise agreement with a binding arbi-

tration clause and was able to retain his or her franchise despite his refusal to sign the mandatory arbitration clause?

Mr. FONDREN. I believe Freightliner has a provision that if a dealer refuses to sign a contract they are automatically terminated.

Mr. NADLER. Are any of you aware——

Mr. HEBE. I am from Freightliner. I will tell you that we have never had a situation where we have had a dealer who has refused to sign his contract was terminated.

Mr. NADLER. Are any of you aware of anybody who is a dealer without a binding arbitration clause?

Mr. FONDREN. Yes. There are dealers who are not subject to binding arbitration. There are many contracts that do not include the clause.

Mr. NADLER. But I mean in situations where the standard contract has such a clause, people who have opted out of it and successfully got a dealership.

Mr. HEBE. Let me clarify Freightliner's position. We have two specific opt-outs. Every dealer who was a dealer prior to the institution of arbitration, our agreements, had the opportunity to opt out.

Mr. NADLER. I understand that. That is not my question. My question is when you give someone a contract and say sign it here and that contract has a mandatory arbitration provision, is there any instance in your history where you are aware of someone who said no, I am going to cross out that and let's sign it any way and you said okay?

Mr. HEBE. No.

Mr. NADLER. Has anybody else had that situation? Then I submit it is clearly a contract of adhesion because you can't assume—because otherwise out of hundreds of thousands of dealers someone would have had that situation.

Now of course one would understand that if someone does not receive a renewable contract he loses the investment, the good will, and the business. Let me ask you a different question. Mr. Hebe, you said that the dealer enjoys the benefits of the substantive provisions of the State law.

Mr. HEBE. That is correct.

Mr. NADLER. Really?

Mr. HEBE. Absolutely.

Mr. NADLER. Given the fact you can't appeal the decision of the arbitrator if the arbitrator should ignore the substantive provisions of the State law, how do you enforce the State law?

Mr. HEBE. Our provisions in our contract with our dealers specifically state that State law prevails.

Mr. NADLER. I understand that. Let's assume the arbitrator ignores the provisions of State law or one of the parties thinks he has ignored the provisions of the State law or has wrongly interpreted the provision of State law. Since there is no appeal how do you make sure that the provision of State law is in fact adhered to?

Mr. HEBE. We have never had that situation but if you don't mind I would check into it and get back to you.

Mr. NADLER. I submit that that is an absurd statement sir, that you have never had that situation. Mr. Wootton stated on behalf

of the Chamber of Commerce the exact opposite of what Mr. Hebe stated. Mr. Wootton stated it does not follow that arbitrators will always ignore certain statutory provisions. They may not always but they may sometimes. Rather, as would be expected in this more informal, agreed upon procedure, those statutes will be followed to the extent the selected arbitrators find them to be applicable given the details of the situation. What you mean is where they think they are wise and intelligent and fair and equitable they follow the statute and when they don't, they disagree with the legislature, they don't think it is equitable, they won't follow the statute, correct?

Mr. WOOTTON. But that is not a distinction with Mr. Hebe. Mr. Hebe says in their contract they said that State law would be followed as a general rule.

Mr. NADLER. Say again, I am sorry.

Mr. WOOTTON. I think what Mr. Hebe said in their contract State law would be followed. What I said as a general rule arbitrators refer to State law but are not bound by it.

Mr. NADLER. In other words, whatever the contract—it is clear that whatever the—that they are not in fact bound by it and that whatever the contract may say, even if the contract binds them to it, if you don't have a system in which decisions of individual arbitrators can be appealed, and you don't, you can't enforce that. When a judge deviates from State law in the opinion of one of the litigants, you appeal that and a higher court decides whether the judge did or didn't deviate from State law. And that is how we enforce the State law and keep the interpretation of State law uniform. But in an arbitration system where there is no appeal, the arbitrator can deviate from State law without saying so to his heart's content.

I don't think anybody can disagree with that conclusion, because there is no mechanism for bringing that arbitrator to a proper interpretation of State law.

Mr. Isralowitz.

Mr. ISRALOWITZ. While appeal rights are limited, there is a right under the Federal Arbitration Act to move to vacate awards. And while those rights are limited, a number of jurisdictions, including the Second Circuit, have recognized that if the arbitrators act in what is called "manifest disregard of the law," that can be a basis for vacating the arbitration award.

Mr. NADLER. How often does this happen?

Mr. ISRALOWITZ. I am aware of a recent decision of the Second Circuit where that happened. I haven't looked at it comprehensively.

Mr. NADLER. Thank you.

Mrs. BONO. Ms. Baldwin, do you have any questions before you run?

Ms. BALDWIN. I wanted to follow on one of the lines of questioning of Mr. Nadler. Does anyone—I think the question was asked if anyone was aware of manufacturers who do not require the binding arbitration clause. Was there a——

Mr. FONDREN. I hope I am responding correctly. Neither Ford nor General Motors as a general practice have mandatory binding arbitration in their contracts. However, both of those companies in con-

tracts involving minority dealers do have provisions that require mandatory binding arbitration. So I hope that that is responsive. They have included them in some of their contracts with a certain class of dealers and they have not included them in other contracts.

Ms. BALDWIN. I had heard one of your competitors, Mr. Hebe, say Volvo trucks does not, in the negotiations with dealers has foregone that option because of the dealership dissatisfaction with such clauses. Are you aware of that with one of your competitors?

Mr. HEBE. I understand that some of our competitors have not included binding arbitration in their agreements. It is my understanding that, yes, Volvo has just recently amended that contract with their dealers to some extent and I am not familiar with the terms.

Ms. BALDWIN. There are a couple of references to provisions relating to surviving spouses taking over dealerships and having limited management roles. Are those still frequently in contracts these days or are those activities of the past?

Mr. FONDREN. To the best of my knowledge, it is still in the Chrysler contract and in the manner that I described. Most State laws prohibit by virtue of the law that type of arrangement, and therefore a lot of them have been abandoned. But they still do exist. And absent State laws, my judgment is that they would be back in the contracts in a very short period of time.

Ms. BALDWIN. Thank you.

Mrs. BONO. Thank you. We have got to run to this vote, but before I do I would like to recognize Mr. Nadler for a brief statement.

Mr. NADLER. Thank you, Madam Chairperson. I ask unanimous consent at this time that all members should be permitted 5 additional days to submit statements and additional materials to the record.

Mrs. BONO. Without objection. I want to thank the witnesses for the time. The hearing has been very helpful and informative and enlightening, and the hearing is adjourned. Thank you.

[Whereupon, at 2:15 p.m., the subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF DONALD P. TINSLEY, CHAIRMAN, THE NATIONAL ASSOCIATION OF MINORITY AUTOMOBILE DEALERS, LANHAM, MD

Dear Chairman George Gekas and Ranking Minority Member Jerrold Nadler:

Thank you for the opportunity for me to present the position of the National Association of Minority Automobile Dealers (NAMAD) before you today regarding H.R. 534, the Fairness and Voluntary Arbitration Act. Before I get into the merits of this legislation, I want to state the unanimous support of NAMAD for this worthwhile legislation. This bill addresses concerns that, quite frankly, minority-owned automobile dealers have been making for quite some time—that mandatory binding arbitration agreements amount to little more than the sharecropping existence that my ancestors worked under in the hills of Kentucky.

My name is Donald P. Tinsley, Sr., and I am the Chairman of NAMAD. NAMAD is a 500-member, non-profit, tax-exempt organization that has its headquarters less than 14 miles away from this hearing room in the suburbs of Maryland. Founded in 1980, NAMAD has been, and will remain, committed to increasing opportunities for ethnic minorities in all aspects of the automotive industry. NAMAD seeks to ensure that there will be a consistent presence of minority entrepreneurs and employees in the retail sales, supplier and service sectors, and the executive and manufacturing ranks of this industry. NAMAD not only fights for fairness for minority automobile dealers, but for all dealers.

I know about mandatory binding arbitration agreements before I entered the automobile industry and after I became a dealer in the early 1970s. I was one of nine children raised in a shack in the country hills of Kentucky. My parents worked hard and taught all of their children the definition of hard work, the value of education, and the importance of being fair. For those who are not familiar with "sharecropping," Webster's *Unabridged Dictionary* defines sharecropping as "a tenant farmer who obtains on credit land, a house, and tools and seeds for farming, from a landowner with whom he shares the crop." When this system of economics prevailed in the wake of the end of the Civil War and the beginning of the Reconstruction era, labor contracts were drawn up that theoretically bound both African American agricultural workers and landowners. Usually, these contracts were tilted heavily in favor of the landowner. According to historian John Hope Franklin, "there was every opportunity for the contracting part[y] not to live up to their word." In this system, "[African Americans] were indebted to their employer for most of what they had made, and sometimes it was more than they made." This system was important because, a century ago, agriculture was vital to the economy of most southern states. A fortunate few were able to eventually own the land that they tilled with the sweat of their brow, the strength in their backs, and the blisters on their hands. My family was one of those fortunate few. In the vast majority of instances, sharecropping only helped the landowner. Despite the onerous economic and psychological pressures incumbent upon the victims of sharecropping, my father was able to get married, graduate from college, and earn a master's degree, while working in the cold, dark and dangerous coal mines of Kentucky. The trial of his labor, combined with his intelligence and keen mind, allowed me to live out and realize my dream of becoming an independent businessman. In the vast majority of instances, sharecropping only helps the landowner.

While we are over a century removed from Reconstruction and are upon the cusp of a new millennium, I am afraid that some things have not really changed at all in the business relationships between automobile manufacturers and automobile dealers. Are we merely witnessing a more modern version of sharecropping when we visit the issue of mandatory binding arbitration and automobile dealers? As you may know, all states, except for Alaska, have statutes regulating the business rela-

tionship between automobile manufacturers and automobile dealers because the sale of new motor vehicles vitally affects the general economy of all of the states in our country. These laws provide necessary safeguards and procedures to help level the playing field and provide basic rights to automobile dealers who invest our life savings in dealership facilities. These state laws became necessary only after abuses due to the enormous disparity in bargaining power and economic position between automobile dealers and manufacturers became manifest. Because of the significant changes in the way automobiles are bought and sold, these state safeguards are extremely relevant and important in today's marketplace.

If this situation is bad for majority dealers, it is a catastrophe for minority dealers. The first African-American to own a new car dealership, Mr. Edward Davis, came into existence shortly before the passage of the Civil Rights Act—less than a generation ago. NAMAD is just experiencing its second generation of minorities who own dealerships. I recall the first contracts that I had to sign in order to become a dealer candidate in 1972, and these agreements were little better than the sharecropping arrangements that my father, and others, had to sign a hundred years earlier. Most minority dealers become so under what are called "dealer development programs." In the Ford Motor Company dealer development agreement, we find the following language, as revealed by testimony in the U.S. Senate Judiciary Committee on March 1, 2000:

> "If appeal to the Policy Board fails to resolve any dispute covered by this Article 10 within 180 days after it was submitted to the Policy board, the dispute shall be finally settled by arbitration in accordance with the rules of the CPR Institute for Dispute Resolution (the "CPR") for Non-Administered Arbitration for Business Disputes, by a sole arbitrator, but no arbitration proceeding may consider a matter designated by this Agreement to be within the sole discretion of one party (including without limitation, a decision by such party to make an additional investment in or loan or contribution to the Dealer), and the arbitration proceeding may not revoke or revise any provisions of this Agreement. Arbitration shall be the sole and exclusive remedy between parties with respect to any dispute, protest, controversy or claim arising out of or relating to this Agreement."

Several automobile and truck manufacturers have added provisions to their franchise agreements with dealers that require dealers submit to mandatory binding arbitration of disputes between dealers and manufacturers. This arbitration provision is mandatory because the franchise contract, unlike many contracts, is not a negotiated document. The manufacturer presents the contract to a dealer, who must take it or leave it. If the contract includes a binding arbitration clause, a dealer must accept the provision or walk away from a possibly viable business opportunity. More importantly, we will be walking away from our dream to which we have invested and committed our live's resources. For example, U.S. Senate Judiciary Committee testimony on March 1, 2000 illustrated the following language that General Motors has for its dealers, referred to as the Operator:

> "The Operator will not be allowed to bring a lawsuit against General Motors for claims arising before and during the time Motors Holding is an investor in the Dealer Company. Instead, the Operator, General Motors and the Dealer Company agree to submit any and and all unresolved claims, including those pertaining to any dealer sales and service agreement, to mandatory and binding arbitration. The results of the arbitration will be binding on the Operator, the Dealer Company and General Motors."

By mandating that all disputes are settled by arbitration, manufacturers can effectively skirt protective state laws and procedures enacted to protect dealers and their businesses. These arbitration panels also circumvent the varied state commissions and boards established to resolve manufacturer/dealer disputes. These proceedings are often not recorded nor are they impaneled before the public.

I have witnessed, first-hand, the evils of mandatory binding arbitration. One of our senior dealers lost the right to build a Saturn dealership in a lucrative market as a result of a mandatory binding arbitration decision. I worry that these decisions will only escalate in the near future, as arbitrators are not required to apply state law and grounds for appeal are severely limited. By signing a mandatory binding arbitration agreement as part of your non-negotiated franchise agreement, a dealer is forced to waive his or her statutory rights and procedures guaranteed to virtually all other tax-paying citizens of our country.

In any business relationship, there will be disputes. There are instances in which arbitration is the best means to settle those disputes without having to go through the time and expense of going to court. NAMAD supports voluntary arbitration to

settle disputes between manufacturers and dealers, and opposes automobile and truck manufacturers forcing dealers to settle disputes through mandatory binding arbitration. H.R. 534, the Fairness and Voluntary Arbitration Act, introduced by House Judiciary Committee Member Congresswoman Mary Bono and supported by 182 other Members of Congress across party and ethnic lines, will correct this current inequity between dealers and manufacturers. This bill is necessary because state efforts to preclude these clauses are generally preempted by the Federal Arbitration Act. This bill would merely amend the Federal Arbitration Act to guarantee that the important decision of waiving established rights and remedies is made freely, without any coercion. This is done by ensuring that both parties to a franchise contract can voluntarily make a decision to arbitrate after the controversy arises. My colleagues in the National Automobile Dealers Association (NADA) and NAMAD have joined forces to ensure passage of this bill. This really is not an issue of majority dealers versus minority dealers, although minority dealers have had to live with mandatory binding arbitration agreements for quite some time. This is really an issue of fairness, equality and good business practices for the foot soldiers of the automobile industry—automobile new car dealers.

I am most proud of my close to five decades of being married to the same person. I am proud of having helped to raise two wonderful, caring children who are great adults making positive contributions to our society. My success in business is because I love being in the car business, and I have dedicated the majority of my life to this enterprise. We do not need to repeat the scurrilous, scandalous and sordid past of glorified sharecropping that mandatory binding arbitration agreements impose upon dealers. The success of individual dealers only translates into success for manufacturers, and we must have a mutually beneficial relationship based on trust, fairness and understanding. NAMAD supports H.R. 534, The Fairness and Voluntary Arbitration Act, and urges that the House Judiciary Committee and Congress pass this important bill as soon as possible.

I thank you for your time.

INTERNATIONAL FRANCHISE ASSOCIATION,
WORLD HEADQUATERS,
New York, NY, May 31, 2000.

HON. GEORGE W. GEKAS, *Chairman,*
Subcommittee on the Commercial and Administrative Law,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: It is our understanding that the Subcommittee on Commercial and Administrative Law will be conducting a hearing on the "Fairness and Voluntary Arbitration Act" (H.R. 534) on Thursday, June 8. The purpose of this letter is to express the serious concerns of the International Franchise Association (IFA) with respect to this proposed legislation.

Established in 1960, the IFA is the oldest and largest trade association representing franchising. Included among our more than 30,000 members are franchisors, franchisees, and suppliers to the franchising community. Such well known companies as McDonald's, Holiday Inn, Subway, Century 21 Real Estate, Lawn Doctor, Meineke Discount Muffler, Sterling Optical, UniGlobe Travel, and Wendy's International are members of the IFA. IFA's mission is to enhance and safeguard the business environment for franchisees and franchisors worldwide. IFA and its members educate the public, lawmakers, the business community, and the media about franchising as a method of doing business. You may recall that four members of IFA testified before your Subcommittee just last year (June 24, 1999) at the oversight hearing which you conducted concerning franchising and the franchise relationship.

As part of the many services we provide our members, IFA endorses a "National Franchise Mediation Program", which assists our member franchisees and franchisors in resolving their disputes outside of court. In fact, since its founding, the IFA has been a strong advocate for the utilization of alternative dispute resolution (ADR) mechanisms. We view ADR as a fair and comparatively inexpensive method of resolving business disputes. Arbitration, of course, is a very traditional and common type of ADR and many of our members have arbitration clauses in their contracts.

Congress passed the Federal Arbitration Act (FAA) in 1925. 9 U.S.C. §§1-16. In enacting this law, Congress utilized its powers to regulate interstate commerce to declare a national policy in favor of arbitration as an alternative method of resolving business disputes. Congress recognized that arbitration was a method of expediting and facilitating settlements—a legitimate alternative to the complications of litigation. The intent was to limit the power of the states to require that there be a judicial resolution of claims, even in instances where the parties had contractually

agreed to resolve their differences through arbitration. Congress specifically intended to reverse the hostility to arbitration that then existed in the courts. At that time, many courts looked with disfavor on arbitration agreements, holding that public policy forbade the specific performance of the agreements.

Thus, prior to the passage of the FAA, a party to a contract containing an arbitration clause could simply refuse to arbitrate and the other party would have no realistic remedy at law. While the nonoffending party could choose to undertake a costly, complicated and time consuming suit for breach of contract—given the widespread judicial hostility that existed to arbitration at that time, the prospect for a successful outcome in favor of the party who wanted to arbitrate was less than promising.

Thus, the bottom line was that a party facing a refusal to arbitrate by the other party had no effective remedy. The FAA was enacted to overcome such an unfair result by holding the parties to the terms of their contractual bargain. The contract commitment to arbitrate was placed on the same footing as any other contractual commitment made by the parties.

There are numerous advantages to using arbitration, as opposed to litigation, as the method of resolving disputes. First, business disputes are generally resolved more quickly through arbitration. Second, since the process is far less formal than the courts (for example, less pre-hearing discovery and less document production are required), arbitration proceedings are typically less expensive than litigation. Third, arbitration allows the parties to maintain privacy and confidentiality that would otherwise not be available if their dispute is litigated in court. Fourth, arbitration also discourages class actions and consolidations. It is the parties themselves that authorize the arbitrator (or arbitration panels) to resolve the matter. Finally, perhaps again, due to its informal nature, arbitration leads to achieve resolution without driving a permanent wedge between the parties, as more adversarial proceeding might.

Also, unlike generalist judges or lay jurors, arbitrators often have specialized knowledge of the subject area (i.e., labor relations, marketing, occupational safety, international law, admiralty, trademarks and other intellectual property) underlying the dispute. Thus, they are able to render a more expert, as well as prompt, decision in many instances. Also, arbitrators have more flexibility than judges in resolving contractual disputes. So, they are in a position to propose a compromise or to seek a middle ground, while judges may be forced to rule one way or the other. Finally, there is less likelihood of frivolous appeals from an arbitrator's decision because the scope of judicial review is more limited and the decision is typically binding. The overall public policy served by encouraging the use of arbitration is that the ever-expanding caseload in the federal and state courts is not further burdened, preventing a further drain on judicial resources. I know that is a matter of serious and ongoing concern to the membership of the House Judiciary Committee and this Subcommittee.

The proposed legislation would amend the Federal Arbitration Act by adding a new section 17 dealing with "sales and service contracts." The bill would allow one party to the contract to prevent the enforcement of a binding arbitration clause in a sales and service contract. It states that, whenever such a contract contains an arbitration clause, either party to the contract may choose to "reject arbitration as the means of settling the controversy." The provision would essentially make a mutual contractual agreement to arbitrate a nullity. It would force non-electing parties into litigation, when the whole purpose of having an arbitration clause to begin with was to avoid the cost, complexity and loss of time connected with litigation. In effect, the bill would place us back to where we were prior to 1925 and the creation of the FAA.

The bill also requires that, where arbitration is elected, the arbitrator provide the parties with a written decision explaining "the factual and legal basis for the award." Taken together with the other provisions in the bill, this could prompt further litigation regarding the validity and finality of an arbitrator's decision.

The sponsors of this H.R. 534 have indicated that the legislation is intended to deal with a particular problem involving automobile manufacturers and their dealers. However, unlike its Senate counterpart (S. 1020), the House bill would prohibit the use of binding arbitration in *any* "sales and service contract." The definition of sales and service contract in the bill is very broad. It would cover any franchise or dealership agreement in any line of business. So, for example, it would apply to computer and electronic equipment outlets, optical service centers, tools and hardware sellers, and specialized automotive repair shops (i.e. transmissions, mufflers, etc.). Finally, the bill is also retroactive. Under section 3 the bill's change in the enforceability of arbitration clauses would apply not just to contracts entered into after the date of enactment but also to the renewal or extension of an existing contract.

In fact, even minor changes ("amended, altered, modified") to the terms of an existing contract would trigger the non-enforceability of an already existing binding arbitration clause in that contract.

The enactment of H.R. 534 in its current form would result in a drastic increase in litigation. Our already overburdened court system would be deciding cases that otherwise would be decided by arbitrators. In addition, the court system would be flooded with motions to vacate arbitration awards, because the bill would seriously erode the finality of any arbitration award. It would be particularly ironic for the House Judiciary Committee, with its long history of supporting ADR mechanisms and, more recently, discouraging frivolous or unfair class actions, to act favorably on a bill that would bring about the opposite result. If the Subcommittee does decide to proceed with this legislation, we strongly urge that it adopt a narrowing amendment to conform the House bill to the Senate bill and limit its coverage to automobile dealership arrangements.

Mr. Chairman, we would appreciate it if this letter could be included in the Subcommittee's record on this hearing. We greatly appreciate your consideration of our views.

Sincerely,

BETSY LAIRD, *Senior Director, Government Relations.*

cc: Hon. Jerrold Nadler, Ranking Minority Member
Members of the Subcommittee

PREPARED STATEMENT OF DAVID GARNETT, EXECUTIVE DIRECTOR, KENTUCKY MOTOR VEHICLE COMMISSION, FRANKFORT, KY

Over 60 years ago, states began to enact franchise protection measures to protect motor vehicle dealers who sought to equalize the economic relationship between themselves and the manufacturers whose new vehicles they were selling. In 1937, Wisconsin was the first to enact a statute requiring dealers and manufacturers to be licensed to do business in the state. The Wisconsin statute utilized an independent state agency to license and regulate dealers and manufacturers.

The reason for the enactment of these statutes is found in the history of the preceding 40-year relationship between manufacturers and franchise dealers. When the production of automobiles began around the beginning of the 20th century, manufacturers were small producers with limited capital and limited production facilities. In those days, sales were made from the factory directly to the consumer. Before long, when manufacturers needed money to expand their production lines, they realized that they had a ready source of funds in capital investments that were tied up in sales facilities. Consequently, manufacturers developed the dealer-distribution network in the early 1900's, so that they could free up their own money for expanded production.

During the early years of the franchise system, the heavy personal investment by a dealer, coupled with a provision in the original franchise contracts which allowed a manufacturer to unilaterally cancel the franchise, made the dealer highly susceptible to threats and coercive tactics. Beginning with the Wisconsin statute, the various states began to regulate relations between franchise dealers and motor vehicle manufacturers as the result of two concerns. The first was a desire to protect against consumer fraud, and the second was to equalize the economic relationship between franchised dealers and manufacturers. In Kentucky, for example, the statute that contains franchise protection measures declares that the distribution and sale of motor vehicles vitally affects the general economy of the state, as well as the public interest and public welfare, in order to prevent frauds, impositions, and other abuses, and to protect and preserve the investments and properties of its citizens. KRS 190.015.

A series of hearings before the United States Senate in 1955–56 led to the passage of federal protections embodied in the "Dealer Day in Court Act," ("DDCA"), 15 USC 1221, et seq.

These hearings elicited testimony of manufacturer overproduction, sales races, and coercion of dealers to take delivery of cars that they did not order, and cars that were difficult to sell. There was testimony that there was a lack of fairness in internal appeal procedures; that franchises were arbitrarily cancelled; that when dealers were forced to sell, they often could not get a fair price because manufacturers refused to approve qualified buyers; that a manufacturer could unilaterally decide to not renew a franchise; that a manufacturer could decide to establish an additional, competing franchise close to an existing dealer; that a manufacturer could offer vehicles, parts, and financing to one dealer on more favorable terms than to another dealer; that a manufacturer could decide how much they would reimburse

a dealer for warranty repairs; that after a dealer heavily invested in all of the things needed to qualify for the franchise, i.e., huying the real estate, building a sales and service facility, acquiring the equipment needed to service vehicles, investing in advertising, and hiring the necessary personnel, the dealer was necessarily bound to the manufacturer; that a manufacturer's control over dealers was extended by the establishment of sales quotas, by the manufacturer's control over a dealer's promotional efforts, and hy a manufacturer exercising almost total control over a dealer's ahility to sell or transfer his husiness; that the almost-total control of a manufacturer over a dealer was manifested through the power of the manufacturer to terminate the franchise with a dealer at any time, for any reason; finally, that unilateral termination was the equivalent of an economic death sentence—the terminated dealer frequently could not get a franchise from another manufacturer, and the dealership facilities were so specialized that they could not be readily adapted to another use. These ahuses resulted in the passage by Congress in 1956 of the "DDCA," providing dealers with a federal cause of action for treble damages based on a manufacturer's failure to act in good faith in performing or complying with the terms of a written franchise agreement.

Kentucky is one of forty-nine states that have enacted laws to regulate the franchise relationship between motor vehicle manufacturers and dealers. (See Kentucky Rev. Stat. Ann. §§190.010 to 190.080). This statute addresses the distribution and sale of motor vehicles in Kentucky. The General Assemhly of the Commonwealth of Kentucky articulated the public policy of this statute in the act itself hy declaring that the distribution and sale of motor vehicles vitally affects the general economy of the state and that it was necessary to license and regulate motor vehicle manufacturers and dealers in order to prevent frauds and other ahuses, and in order to protect and preserve the investments and property of the citizens of Kentucky. The Kentucky General Assembly recognized the need for statutory protections to insure fundamental fairness in the economic relationship between a franchise dealer and a manufacturer. It recognized the unequal hargaining power exercised hy a manufacturer when it provided that, *regardless of the terms of the franchise agreement,* a dealer will retain certain fundamental rights.

In order to assure the protection of those rights and that the distribution and sale of motor vehicles is conducted in accordance with the state franchise law, the Kentucky General Assembly created the Motor Vehicle Commission. In addition to licensing and regulating dealers and manufacturers who do business in Kentucky, the Commission provides a neutral, cost-effective dispute resolution system that applies Kentucky law in a forum that is convenient to the parties and that allows dealers and manufacturers to settle disputes outside of the courts.

Motor vehicle franchise contracts continue to be non-negotiated. They are drafted by manufacturers and presented to dealers on a take-it-or-leave-it basis. Consequently, manufacturers can unilaterally insert mandatory binding arhitration clauses in the agreements. Under the Federal Arbitration Act, arhiters are not required to apply state law, allow discovery, or provide a written decision. Rights of appeal are severely limited. Conversely, the manufacturer- dealer dispute resolution systems set up by the various states allow those disputes to be heard and decided according to each state's specific interests, as codified by that state's statutes.

A state legislature's expression of intent to protect and preserve the investments of its citizens should be accorded deference. Since the history of motor vehicle manufacturer-dealer relations is replete with examples of disparate hargaining power, a state's efforts to level the playing field should be respected. The unilateral imposition of mandatory and binding arbitration removes a state's interests from the equation. That removal would be remedied by the passage of H.R. 534. I urge the Subcommittee to promptly and favorably report this measure to the full committee.

Thank you for this opportunity to submit this testimony.

PREPARED STATEMENT OF JOAN CLAYBROOK, PRESIDENT, PUBLIC CITIZENS CONGRESS WATCH, WASHINGTON, DC

Chairman Gekas and Members of the Subcommittee, Public Citizen is submitting this testimony because we believe that the use of mandatory pre-dispute arbitration clauses presents a grave prohlem for consumer rights and public safety. The use of mandatory pre-dispute arbitration clauses is growing at an alarming rate and congressional action is urgently needed. If the trend continues, soon we will have a private justice system adjudicating disputes that is largely controlled hy corporations.

We appreciate the power imhalance in contractual relationships and unfairness in forcing the less powerful party to waive the right to seek redress in court. The same

arguments which support the argument against enforcement of these provisions in business-to-business contract apply more strongly to consumer contracts.

We applaud the proponents of H.R. 534 for raising the issue of unfair mandatory pre-dispute arbitration. However we believe that the bill does not go far enough because it addresses only arbitration clauses in contracts between businesses and would leave consumers disputes with businesses or employee disputes with employers out in the cold. If this Committee proceeds on the issue of arbitration, Public Citizen recommends the following:

- Congress should amend the Federal Arbitration Act to remove the judicially-imposed federal preemption of state regulation of arbitration agreements, so that states have the ability to regulate arbitration procedures if they desire to better protect consumers and employees or to deal with specific local problems.
- State and Federal legislators should pass legislation to ensure that parties with weaker bargaining positions are not forced into unfair arbitration. This legislation should take the form of an absolute ban on mandatory, pre-dispute arbitration clauses. Alternatively, legislation could make all such clauses in contracts between unequally powerful parties unenforceable. At a minimum, mandatory, pre-dispute arbitration clauses should be unenforceable in all consumer and employee contracts.
- Congress and the States could promote fair arbitration by passing an Arbitration Bill of Rights. The Bill of Rights would be designed to make arbitration an attractive alternative that a fully-informed consumer would voluntarily choose to resolve a pending dispute by ensuring fair selection of arbitrators, fair distribution of arbitration costs, full and fair discovery and appealability of awards.

If this Committee is not prepared to go beyond H.R. 534, at a minimum an amendment should be passed prohibiting businesses that would benefit from the protections in this bill from using mandatory, pre-dispute arbitration contracts in their contracts with customers or their employees.

INTRODUCTION

Public Citizen is a nonprofit, national consumer advocacy organization with approximately 150,000 members nationwide. One of our primary goals is to assure that injured consumers and workers have the ability to hold responsible and receive fair compensation from the wrongdoers that injured them.

On behalf of consumers and small businesses, Public Citizen's Litigation Group has argued two cases in the U.S. Supreme Court on arbitration issues and many more in lower courts. In *Barrentine* v. *Arkansas-Best Freight System*, 450 U.S. 728 (1981), the Supreme Court upheld Public Citizen's contention that a union contract arbitration clause did not preempt the drivers' right to sue with regard to a statutory claim under the Fair Labor Standards Act. In *Doctor's Associates* v. *Casarotto*, 517 U.S. 681 (1996), Public Citizen argued before the Supreme Court that states had an inherent interest in ensuring the fairness of arbitration agreements in all contracts. Unfortunately, the Court ruled that the Federal Arbitration Act preempted state protections, helping create the problem this hearing is exploring: the injustices that occur when the weaker parties to a contract are forced involuntarily into arbitration proceedings stacked against them.

We make the following recommendations with respect to H.R. 534 and mandatory pre-dispute arbitration in general:

PART I—CONGRESS SHOULD REVIEW THE INJUSTICE OF PRE-DISPUTE, MANDATORY ARBITRATION AND RESTORE THE CONSTITUTIONAL RIGHT TO FAIR DISPUTE RESOLUTION

The use of mandatory pre-dispute arbitration clauses is rising at an alarming rate in consumer and employment contracts. Today's hearing focuses on a bill that only addresses business to business contracts, and as such falls far short of the scope of the problem. For instance, the auto dealers, from which two representatives are appearing before you, are seeking relief from mandatory, pre-dispute arbitration contractually imposed upon them by the much more powerful auto companies. The dealers feel they have little ability to stand up to the auto manufacturers and distributors who use their power to impose these unfair clauses in the contracts vital to the dealers continued existence.

At least the dealers have some leverage as the auto companies need them to sell their cars. Imagine the fate of individual consumers or employees in such unbalanced situations.

Ironically, many of these same auto dealers are at the forefront of a trend to impose mandatory pre-dispute requirements on the consumers who purchase their cars.

I refer you to the attached exhibits showing that immediately after the U.S. Supreme Court's decision on January 18, 1995 ruling in favor of enforcing mandatory pre-dispute arbitration clauses in *Terminix* v. *Dobson*, auto dealer organizations began advising dealers to require arbitration clauses in their sales and service contracts with their consumers. As stated by one auto dealer association, the reason for requiring customers to sign mandatory pre-dispute arbitration clauses was to "substantially reduce the likelihood of sustaining large punitive damage judgments." Furthermore, the auto dealers are advised that "arbitration must be agreed to at the time of sale or lease, not when the dispute arises" so that the customer has no alternative to arbitration.

The pervasive use of mandatory pre-dispute arbitration clauses in the auto industry is best illustrated by a startling exception to the trend. I refer you to the attached exhibit of an advertisement for an Infiniti car dealer. The Brewbaker Infiniti dealership in Montgomery, Alabama, advertised that it would sell cars *without requiring arbitration*, although the dealership will continue to "ask customers to sign arbitration." The special promotion was limited, however, to new Infiniti cars. The dealer still *"required"* arbitration clauses to be signed for the purchase of used Infiniti's, repair orders and body shop tickets *"as a condition of sale."* Moreover, as the advertisement states, the bank finance contracts the customer would need to sign in order to finance their purchase of a new Infiniti could still require arbitration. The use of non-negotiable, mandatory pre-dispute arbitration clauses has become standard practice to such a degree that not requiring arbitration is an advertising 'hook,' though rendered impotent by the small print exceptions.

Consumers buying or repairing automobiles suffer from the same or greater disparity in bargaining power with the dealers as the dealers do with the manufacturers. Perhaps the subcommittee would consider expanding the scope of H.R. 534 in order to provide protection for all parties without the power to negotiate contract provisions and thereby restore all their rights to just dispute resolution.

Public Citizen is not opposed to arbitration per se. There is social benefit in voluntary arbitration as a fair and expeditious alternative to litigation. However, an arbitration agreement must be entered into voluntarily *after* the dispute arises and the consumer, employee—or even the small business owner such as an auto dealer—knows which rights she is waiving, who will arbitrate the dispute, who will bear the costs of arbitration, whether discovery will be allowed, what law will be applied, what information will be public, and whether she will have recourse following the award. Without a fully-informed voluntary consent, arbitration loses all credibility as a just alternative to litigation.

In the real world, most contracts are not made by equally powerful and knowledgeable parties. While this is certainly true of employment and consumer credit contracts, it is equally true for virtually all consumer contracts, as well as business-to-business contracts between disparately-sized companies. As Part II of this testimony reviews in detail, mandatory, pre-dispute arbitration clauses can never be fair, when the parties do not have:

- Equal bargaining power,
- Equal experience in arbitration,
- Equal ability to understand the consequences of contract language, particularly the ramifications of the rights being waived, and an
- Equal ability to insist on clauses being included or excluded in the contract.

Without this balance of power, there can be no effective voluntary consent to mandatory, pre-dispute arbitration clauses.

Public Citizen believes that the escalating use of mandatory, pre-dispute arbitration clauses in contracts between unequal parties is impinging on individuals' basic rights as guaranteed by the Constitution's Bill of Rights. The Seventh Amendment to the U.S. Constitution states, "In suits at common law, where the value in controversy shall exceed $20, the right of trial by jury shall be preserved . . ." When the Bill of Rights was passed, the right to a jury trial was the only Amendment of the 10 proposed that was approved by all 13 states. The right to a civil trial was included in the Constitution because that right was a critical issue in the decision of the colonies to revolt against the arbitrary decisions of King George III. More than giving individuals a right to a particular procedure, the Bill of Rights guarantees public legal proceedings where the lowly and the mighty are equal and have the same ability to receive justice.

The escalating use of mandatory, pre-dispute arbitration clauses threatens that fundamental freedom. These clauses are designed to give businesses significant advantages in their disputes with consumers and employees. They threaten the very basis of our justice system—equal justice under the law.

The profundity of this rising tide of mandatory, pre-dispute arbitration agreements and its effect on the right to trial by jury has not yet fully been felt. But the reality is that too many of America's businesses are trying to opt out of the American judicial system—by exempting themselves from the rules of conduct and responsibility to which the rest of us are held. By insisting that consumers and employees waive their right to their day in court as a precondition to doing business, corporate America is trying to insulate itself from the consequences of doing business negligently, recklessly and in violation of the law.

The result will be the creation of a massive system of arbitrators parallel to, but untouchable by, the courts. Consumer and employee rights, public safety and public policy will be weighed by arbitrators neither elected nor appointed under any legal system. We may be witnessing the birth of a private judicial system—created by corporations seeking to avoid legal responsibility for their actions. As Judge Harry Edwards put it, an arbitrator "serves simply as a private judge . . . yet unlike a judge, an arbitrator is neither publicly chosen nor publicly accountable." *Cole* v. *Burns International Sec. Servs.*, 105 F.3d 1465, 1476 (D.C. Cir. 1997).

We now have 75 years of experience under the Federal Arbitration Act (FAA), which sets the fundamental ground rules for arbitration. In its present form, the FAA is fostering arbitration procedures that severely weight the scales of justice toward large businesses and away from consumers, employees and small businesses.

Public Citizen believes that this threat to fundamental concepts of American justice is so significant that the U.S. Congress and the states' legislatures should work together to adopt policies that restore citizens' fundamental rights to impartial, unbiased and public adjudication of disputes. Without such a system of fair redress in a civil society, citizens will start to take the settlement of disputes into their own hands with potentially disastrous results. We propose a comprehensive federal-state legislative initiative to achieve these goals:

- Congress should amend the Federal Arbitration Act to remove the judicially-imposed federal preemption of state regulation of arbitration agreements, so that states have the ability to regulate arbitration procedures if they desire to better protect consumers and employees or to deal with specific local problems. While federal legislation should establish basic minimum standards to guarantee arbitration fairness, states should be able to give consumers additional protections such as deciding whether arbitration is appropriate in a given situation or whether notice provisions or arbitration procedures are necessary to protect their citizens. Federal law should provide a foundation upon which the states could build greater consumer protection.
- State and Federal legislators should pass legislation to ensure that parties with weaker bargaining positions are not forced into unfair arbitration. This legislation should take the form of an absolute ban on mandatory, pre-dispute arbitration clauses. Alternatively, legislation could make all such clauses in contracts between unequally powerful parties unenforceable. At a minimum, mandatory, pre-dispute arbitration clauses should be unenforceable in all consumer and employee contracts.

  The Senate Judiciary Subcommittee on Administrative Oversight and the Courts began to take this approach recently when it held a hearing on S. 121, the Civil Rights Procedures Protection Act and S. 2117, the Consumer Credit Fair Dispute Resolution Act. Public Citizen testified in support of both S. 121 and S. 2117 at the hearing on those bills on March 1, 2000.

  S. 121 would expressly prohibit the use of arbitration or other alternative dispute resolution procedures in federal civil rights discrimination claims unless the claimant voluntarily agrees to arbitration after the claim arises. Employers should not be allowed to force employees charging their employers with illegal discrimination into an unfair dispute resolution scheme of the companies' own device.

  S. 2117 would make mandatory arbitration clauses in consumer credit contracts invalid and unenforceable unless the consumer voluntarily agrees to arbitration after the controversy has arisen. Mandatory arbitration schemes in consumer credit adhesion contracts deny consumers their right of access to the courts and the protection of state consumer laws.

  Both S. 121 and S. 2117 would not eliminate arbitration in these situations, but would harness market forces to reduce current abuses. After a dispute has arisen, if both sides believe it is in their interest to proceed to a

specified arbitration forum, they may agree to do so. After the dispute, both parties have inducements to pay attention to the equities of the arbitration procedure. If a consumer or employee is only offered a biased or procedurally unfair arbitration, then she will not choose arbitration. Therefore, the legislation provides the proper incentive to make these voluntary arbitrations demonstrably fair.

Eliminating the ability of the more powerful party to force the weaker party into unfair arbitration would go far toward eradicating the problems detailed in Part II of this testimony. Consumers and employees should be able to choose whether to go to arbitration only after the controversy arose. At that time they would have the proper incentive to carefully assess the pros and cons of the proposed arbitration and determine whether it would be a fair dispute resolution mechanism. Essentially this would institute a market-oriented system where parties who believe arbitration is the best forum would have to design arbitration systems that are attractive because they are fair to the other party.

- Congress and the States could promote fair arbitration by passing an Arbitration Bill of Rights. The Bill of Rights would be designed to make arbitration an attractive alternative that a fully-informed consumer would voluntarily choose to resolve a pending dispute by ensuring fair selection of arbitrators, fair distribution of arbitration costs, full and fair discovery and appealability of awards. An Arbitration Bill of Rights should include:
  - A mutuality requirement—parties should have identical opportunities to access the courts. One-way "agreements" favoring corporations should be prohibited.
  - Proof that both parties are actually aware of any arbitration provision in a contract.
  - Full disclosure about the arbitration process, including specific information about what kind of claims and rights are being waived and about the costs of pursuing arbitration.
  - True choice—the ability to reject the arbitration clause without jeopardizing the employment opportunity or consumer transaction.
  - Judicial review of awards on the merits.
  - Availability of all judicial remedies, such as injunctions and punitive damages.
  - A fair system of cost allocation that does not deter or preclude valid claims from being made.
  - A choice of venue that is convenient to the party less able to bear the costs of travel.
  - Discovery to ensure the ability to pursue and prove the claim.
  - A requirement for a written opinion by the arbitrator explaining bases of findings of fact and applications of law.
  - Public records of arbitration awards so that consumers as well as corporations can learn about the arbitrators' past decisions and any previous awards on similar disputes.

PART II: MANDATORY ARBITRATION ABUSES

The Scope of the Problem

Over the past several years, more and more consumer creditors have inserted mandatory pre-dispute arbitration clauses in the fine print of their consumer credit contracts. You may not know it, but if you have a credit card, mortgage or other credit account with BancOne, First USA, GE Capital, Discover, American Express, Household Financial or Beneficial Financial Services; if you belong to an HMO or investment group; if you recently bought a personal computer, cell phone, mobile home, or product over an Internet site such as e-Bay; or if you bought a new home from a fly-by-night contractor, you have probably waived your rights to take those corporations to court if they harm you by breaching their contract or even by defrauding you.

You might be blissfully unaware that you have forfeited your right to a day in court, because the mandatory arbitration agreement was lurking in the fine print of your car lease or tucked in with the offers of personalized check printing from your credit card company, or perhaps in your teenager's employment contract with the local burger joint. By accepting the car lease, using your credit card or taking the job, you and your family forfeited one of the most treasured American rights—

the right to a day in court and a jury of your peers to judge whether you have been wronged.

If you don't know whether you have waived your rights to access the judicial system, you are not alone. You likely didn't read through the entire cell phone contract, or didn't notice the arbitration clause in your car lease. Like most Americans, you might not have understood that the clause meant you were forfeiting your constitutional rights as a consumer, rights that protect your health and safety and protect you from fraud.

If you did see the arbitration clause in your credit card contract, you might have thought that it might not be such a bad thing. Before any dispute has arisen between you and your creditor or service provider, the prospect of such a dispute is distant and theoretical. Arbitration might even sound better than litigation should the unthinkable happen and you and the company you are doing business with have a falling out. But the average consumer (and even the more sophisticated consumer) does not consider the breadth of rights waived by agreeing to the clause.

You should also be troubled that you had no choice but to agree to the mandatory arbitration if you wanted to make the transaction. It was not a term you could negotiate out of the contract—most mandatory arbitration clauses are in standard form, take-it-or-leave-it contracts. And you could hardly "leave it" and go to another creditor or retailer because more and more of them insist you give up your rights. In these situations, it is manifestly unfair to allow these contracts of adhesion (one-sided contracts that are not negotiated by the parties and are embodied in a standardized form prepared by the dominant party) to take away consumers' constitutional rights of access to the courts to protect their rights. The power imbalance at the moment of contract is tremendous and without any real remedy for consumers, abuses will soar to new heights.

In the employment context, the power imbalance is even more obvious and insidious. There is no true voluntary assent to mandatory arbitration clauses when employees are told to either assent or lose their jobs and applicants who refuse simply are not hired. Very few job seekers are in a position to refuse proffered employment, which would provide the means to support their family, in order to preserve a comparatively intangible right should an unforseen problem develop years later.

Some courts have recognized the extreme power imbalance and lack of true bargaining power in employee contracts, particularly when the employee seeks to invoke state or federal anti-discrimination policy. Those courts have refused to enforce a mandatory, pre-dispute arbitration clauses. Unfortunately, other circuits have held such clauses are enforceable.

The Federal Arbitration Act and Its Preemption of Consumer Protection and Anti-Discrimination Law

The Federal Arbitration Act (FAA) of 1925 grew out of international maritime dispute resolution systems. In that commercial context, companies have essentially equal bargaining power and can negotiate over the suitability of adopting alternative dispute resolution systems such as arbitration.

However, in consumer credit and employment contracts, as well as in other transactions between individual consumers and businesses, the parties have extremely unequal bargaining power. In consumer credit contracts, consumers often don't even see the full language of the contract until the credit application or the consumer purchase has been completed. Job seekers focus on pay and benefit packages and are seldom in an economic position to insist on rights they never expect to use.

Many state legislatures have recognized these problems and have been particularly concerned about individuals in these types of adhesion contracts, where they are faced with signing take-it-or-leave-it contracts for employment or credit without the option to strike the arbitration clause or negotiate the terms. Some states have passed laws to protect consumers in those situations. Some have required arbitration clauses to be particularly visible to ensure that consumers know what they are agreeing to. Other states have disallowed pre-dispute arbitration agreements in particular subject areas of law, such as employment discrimination disputes, because they deemed arbitration to be unsuitable to enforce their state's public policy in those critical areas.

However, the Supreme Court has interpreted the Federal Arbitration Act as preempting those consumer and employee protection efforts by individual states. Despite the extreme power imbalance in formulating these contracts, the Supreme Court has in a series of decisions ruled that Congress' intent to promote arbitration preempts state regulation. The Court has enforced pre-dispute arbitration agreements even in consumer credit and employment contracts.

In particular, the Court has invalidated all state laws that single out as unenforceable arbitration provisions in contracts that are otherwise enforceable. Under

the Court's rulings, the only way a state court may avoid enforcing a pre-dispute arbitration agreement is by voiding the contract under traditional, general contract rules regarding consent, fraud, unconscionability and revocation. State legislatures cannot pass a bill that just regulates arbitration abuses; they can only legislate general contract law changes. But mandatory arbitration clauses are different. They should not be treated the same as any other contract term (such as price, quantity, dates of service, etc.) because:

- The constitutionally protect right to a day in court is too important;
- Consumers do not fully understand the importance of the rights they are waiving until a dispute actually arises; and
- The enforceability of the entire contract depends on the fairness of the arbitration provision because the consumer can have them enforced nowhere else.

In other decisions, including *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991), the Supreme Court ruled that absent proof that Congress intended civil rights legislation to preclude arbitration, contractual mandatory pre-dispute arbitration can be enforced. The Court cited the FAA's provisions that manifest a "liberal federal policy favoring arbitration agreements."

Because the Supreme Court's decisions interpreted the U.S. Congress' intent in adopting the FAA, Congress has the responsibility to revise the law to level the playing field for the consumer and employees and restore their fundamental legal rights.

Mandatory Pre-Dispute Arbitration Clauses Are Discriminatory and Unfair

In addition to the denial of consumers' and employees' rights to seek remedies in court, arbitration between two parties with unequal bargaining power is too often a discriminatory and one-sided process, benefitting the corporations mandating it. The following are problems faced by consumers and employees who are forced into arbitration by contracts written solely by the corporation:

- *Substantial up-front costs.* For most consumer transactions and many employment disputes, the fees imposed by mandatory arbitration may make it economically impossible for consumers or employees to vindicate their rights. Many arbitrators require hundreds of dollars in filing fees and hundreds or thousands more in hearing fees. Some consumers, particularly those who have just suffered a financial loss, will be unable to pay these fees and will therefore be precluded from any remedy. Similarly, high fees may preclude employees whose financial future may already be endangered because of their employment dispute from pursuing their anti-discrimination claims. In other consumer claims, the small amount in dispute may actually be less than the arbitration fees, making any arbitration a losing proposition economically. In contrast, most jurisdictions provide consumer access to small claims courts with minimal fees and costs.
- *Prohibition of class actions.* Certain harms inflicted on consumers may be small yet widespread so that they would be impractical to pursue unless brought as a class action. Companies are using mandatory arbitration clauses to avoid class actions, making it impossible for plaintiffs with small claims to pursue their cases or afford any legal advice. The prohibition on class actions thereby provides legal immunity for corporations who may have gained a substantial benefit through small injuries to a large number of persons.
- *Choice of venue.* Arbitration clauses often include a venue selection that favors the corporation, such as requiring arbitration in a location inconvenient to the consumer. Thus, consumers may find themselves having to bear the cost of long-distance travel to make their claims heard. For example, the Internet auction site e-Bay requires its customers to travel to its home turf of San Jose, California, to arbitrate any dispute. This requirement is obviously an impediment to justice for modest disputes of a couple of thousand dollars or less.
- *One-way agreements.* Many arbitration clauses require only one side (the consumers or employees) to resort to arbitration on a particular claim, while allowing the other side (the corporation) to sue in court on the same claim. In addition, sometimes only one side (the consumers or employees) is bound by the outcome of the arbitration while the other (the corporation) is not. Arbitration clauses also may provide certain remedies for one side but not the other—for example, allowing the imposing corporation to be awarded attorney fees, but not the consumer on whom arbitration has been imposed.

- *Choice of arbitrator.* Many arbitration clauses give the company the right to pick the arbitrator, formulate the list of possible arbitrators from which the consumer or employee must select, or select the arbitration organization. When companies establish relationships with arbitration organizations to handle their continuing business, arbitrators have a self-interest in favoring the company in their decisions in order to attract repeat business. Moreover, neither arbitrators, nor those that impose arbitration, are required to keep a public archive of decisions. Therefore, consumers and employees suffer from the disadvantage of not being able to check for biases in prospective arbitrators, even when they have some role in choosing them.
- *Lack of a public record.* Because in many cases no written decisions are made available and most arbitration clauses require that all facts relating to a dispute are confidential, public discussion on the validity and fairness of a given arbitration finding is discouraged, no legal precedents or rules for future conduct are set and individuals cannot cite previous decisions for precedential effect. Imagine if we had never learned about tobacco company misbehavior from the Minnesota litigation.

  Since businesses that impose arbitration are likely to keep an archive of decisions, they enjoy the advantage of being able to choose those arbitrators that have ruled for them. And with no public record, the companies can present to the arbitrator favorable cases from their own files while not disclosing cases favoring the employee or consumer.
- *Lack of discovery requirements.* Many arbitration schemes greatly restrict discovery, the process by which parties obtain information from one another, even though in-court claims cannot be litigated effectively without it. The lack of discovery and adherence to rules of evidence and procedure in arbitration amounts to the wholesale denial of one of the most basic rights in our civil justice system. Lack of discovery may make creditors' and employers' discriminatory behavior impossible to prove. Consumers and employees are prevented from discovering patterns of abuse that would reveal the corporation's culpability; this immunizes companies from sanctions, including injunctions, sufficient to deter continued wrongdoing.
- *Limited judicial review.* Under the FAA, parties are allowed only limited judicial review of an arbitration award and virtually no review of the substantive merits of the award. The courts can review for bias in the process, partiality by the arbitrators, and whether the arbitrators exceeded their powers. But to overturn a decision on substantive legal grounds, the appellant must show "manifest disregard of the law," an extraordinarily difficult standard to prove. The true scope of review is even more limited because often there is no requirement for any written opinion and no requirement that any voluntarily prepared written opinion include a statement of what law the arbitrators applied or what facts were deemed proven. Any consumer wishing to show bias or partiality or error in applying law or finding fact has an extraordinary burden to meet, particularly where no records of the company's dealings with the arbitrator are made public and no discovery rules provide for their disclosure.
- *Arbitration is ill-suited to decide causes of action based on statutes involving preferred public policies such as civil rights protections.* Statutory rights and remedies are not fully vindicated in the arbitration process. The use of unilaterally imposed pre-dispute mandatory arbitration clauses in employment contracts as a condition of employment harms both the individual employee and the public interest in eradicating civil rights violations. *Those who the law seeks to regulate should not be allowed to exempt themselves from the enforcement of civil rights laws.* Nor should they be allowed to deprive the civil rights claimants the ability to vindicate their rights in a court of law by a jury of peers.

  Likewise, consumer protection statutes designed to ensure the public's safety embody important public policies. Corporations should not be allowed to avoid those policies, by forcing individuals into arbitrations where their rights are not protected.
- *Limited remedies.* Mandatory pre-dispute arbitration clauses may eliminate some remedies, such as injunctive relief and punitive damages, or shorten the time within which a claim must be brought. These provisions circumvent carefully considered and crafted laws governing the creditor/consumer and employer/employee relationships. Many claims are not worth bringing without the prospect of full legal remedies. By inserting these clauses into their contracts, creditors and employers intend to prevent legitimate claimants from ever receiving justice.

Examples of How Current Arbitration Law Is Fundamentally Unfair to Consumers and Employees

Unfortunately, examples of how mandatory arbitration has unfairly twisted the resolution of disputes are quickly accumulating day by day. The Washington Post (3/1/00, pp. E1/E10) revealed that for just one large company, First USA, mandatory, pre-dispute arbitration had resulted in 19,705 arbitration awards over the last two years. Only 87 were decided in favor of the customer; First USA won 99.6% of the cases.

The following real life examples demonstrate how consumers and employees are severely disadvantaged by the mandatory arbitration process. As other consumers and employees have similar experiences, most injured persons will choose not to pursue their legitimate claims because the likelihood of a fair hearing and decision is so small.

• *Contractor/Finance Company Fraud*

Harris v. *Green Tree Financial Corporation* (183 F. 3d 173; Third Circuit, 1999) illustrates how the courts have interpreted the Federal Arbitration Act in a way that is fundamentally unfair to consumers.

The Harrises were approached by home improvement contractors marketing themselves as Federal Housing Authority and U.S. Department of Housing and Urban Development-approved dealers promising affordable work with no payment required until the customer was satisfied with the construction.

In fact the contractors themselves had been solicited by Green Tree Financial Corporation to encourage consumers to use high-interest rate secondary mortgage contracts to finance home improvements.

The Harrises allege that they received little of value from the contractors, but were saddled by sizeable debt secured by mortgages on their homes. When they attempted to sue Green Tree and the contractors alleging fraud and breach of contract, Green Tree moved to compel arbitration.

The work orders for the home improvements that the Harrises originally signed when agreeing to have the work done did not mention arbitration. However, the secondary mortgage contract (described to them as standardized contracts that needed to be signed before construction could begin) included an arbitration clause in small print on the back page near the end of the contract.

The arbitration clause was not only boilerplate language about which the Harrises had no opportunity to bargain, but the clause bound only the Harrises, not the contractors or Green Tree. The companies who allegedly defrauded the Harrises retained their right to go to court to enforce the mortgage or to foreclose on the real property secured by the loan.

Despite the lack of effective notice, the unequal bargaining power of the parties, the use of a boilerplate contract of adhesion, and an arbitration clause that only bound one party to the contract, the Third Circuit upheld the arbitration clause. It found that the District court had erred in holding that the clause was not enforceable because of lack of mutuality or procedural or substantive unconscionability. The court then used the FAA's "liberal policy favoring arbitration clauses" to bar the courtroom door to these defrauded consumers, forcing them into arbitration where all the advantages lie with the repeat user of arbitration, not the one-time consumer complainant.

• *Automobile Consumer Credit Fraud*

On January 31, 1999, Ann Brown of Sandusky, Ohio borrowed $5,500 at 25% interest from a J.D. Byrider Franchise car lot to finance her purchase of a car from Byrider's used car lot. The car turned out to be a "junker" and a safety hazard. The entire wheel and axle fell off when Ms. Brown's teenage daughter was driving down the road. In her lawsuit in Ohio court, Ms. Brown alleged that she was forced to pay an artificially inflated price in violation of the Truth in Lending Act. Ms. Brown also alleged that Byrider violated the Truth in Lending Act by requiring her to accept an $895 warranty fee that was also to be financed by J.D. Byrider at 25% interest. In addition, Ms. Brown alleged violations of the Ohio Sales Practices Act and fraud.

But Ms. Brown was denied her day in court by the district court in Ohio, which ruled that the arbitration agreement contained in Ms. Brown's contract had to be enforced because of the Faa's policy favoring arbitration. Under that arbitration clause, Ms. Brown lost all her claims under state and federal lending and consumer protection laws although Byrider retained the right to sue her. She also waived her right to punitive damages, no matter how reckless or malicious Byrider's conduct. Instead, she must proceed under Byrider's choice of arbitration, for which she must pay half the costs and attorney fees. The costs of arbitration, which begin with

$300–$500 filing fees and approximately $1,500 per day arbitrator's fee, exceed the value of her claim. It is simply not worth it to take the case to arbitration. In sum, Byrider is using this arbitration clause to insulate itself from the consequences of violating the Truth in Lending Act, Ohio Sales Practices Act and flat-out fraud.

Ms. Brown did not understand that she was waiving her right to go to court when she signed an arbitration agreement with Byrider. This is hardly surprising because the Byrider financing officer himself had no idea what arbitration is or what the rules of arbitration are, so he was unable to tell Ms. Brown what rights she was waiving. Nor was she given an option—the credit contract was presented in a standard form, take-it-or-leave-it format and she was not allowed to challenge any of its provisions. The mandatory arbitration provision only applied to Ms. Brown. Had she defaulted on her loan, Byrider would have been able to file a lawsuit against her.

When Ms. Brown first filed her lawsuit, Byrider stopped using the mandatory arbitration clauses in their contracts. But once the courts refused to vindicate Ms. Brown's rights in court in favor of arbitration, Byrider began using the clauses again. Ms. Brown's attorneys have received inquiries from over 40 consumers similarly defrauded by Byrider. Unfortunately, no matter how many of J.D. Byrider's former customers are defrauded, they cannot file as a class action because the mandatory arbitration clauses in their contracts waive their right to maintain class actions.

- *Sexual Harassment*

In a San Francisco, California case a woman named Sherry claimed that her employer, a prominent physician, physically and verbally sexually harassed her. Whether her claim was legitimate or not we will never know, but there was a great deal of evidence supporting her allegations, including: corroborating testimony from another employee, an admission that the defendant had been "squeezing titties," a calendar owned by the defendant showing his female employees nude, and expert testimony from a psychologist. Sherry filed suit in 1994 for violations of her civil rights.

The defendant employer had included a mandatory arbitration clause in the plaintiff's employment contract, although Sherry did not see the arbitration material until she had been working a week. At that time, the document was given to her while she was working and she was told that it was necessary for her to sign it to keep working; she was given no time to read the document. In addition, Sherry did not understand the mandatory arbitration clause or its significance. Despite this clear evidence that Sherry had not agreed to waive her rights, the court ruled that Sherry was bound by the clause and could not sue her employer in court.

Sherry took her case to arbitration under the American Arbitration Association (AAA). After three years and eight days of hearings, the arbitrator found in favor of the defendant. The result in the case perplexes civil rights attorneys—and with good cause. The arbitration proceedings were conducted behind closed doors and the legal and factual bases for the arbitrator's decision are not publically available.

Most shocking in Sherry's case is that the arbitrator also found Sherry liable for over $207,000 in attorney fees to pay the defendant's attorneys. Under civil rights litigation in the federal and state courts, such attorney fees are only awarded for frivolous or bad faith suits, because public policy favors the bringing of such suits. In addition, the cost of the arbitrator and the AAA's fees totaled $16,000, compared to the $200 filing fee for a court case.

Sherry's ability to vindicate her civil rights was hampered in part by her inability under the arbitration rules to conduct discovery and develop a full factual record. Future employees who are discriminated against will not be able to use Sherry's experience to assist in building their cases. Under the arbitration procedure, both Sherry and her attorney are effectively gagged and cannot discuss the case without risking a lawsuit, which, ironically enough, the employer would be able to pursue in court.

The outcome in Sherry's case will act as a deterrent to others wishing to bring suit for sexual harassment when there is a mandatory pre-dispute arbitration agreement in their employment contracts. And more ominously, it will encourage employers to use pre-dispute arbitration clauses to insulate themselves from civil rights laws.

CONCLUSION: H.R. 534 IS FUNDAMENTALLY FLAWED BECAUSE IT FAILS TO ADDRESS THE GROWING CRISIS OF MANDATORY, PRE-DISPUTE ARBITRATION CLAUSES IN CONSUMER AND EMPLOYMENT CONTRACTS.

As noted in Part I of this testimony, Public Citizen believes that the current state of arbitration law has resulted in a corruption of citizens' fundamental rights to equal justice under the law. We have suggested a comprehensive legislative initia-

tive to resolve the problem. First, the Federal Arbitration Act should be amended to remove the judicially-imposed federal preemption of state regulation of arbitration agreements so that the states may protect consumers and employees from unfair arbitration clauses. Second, legislation should be passed to allow each side in a dispute to choose arbitration or litigation after the dispute arises. Third, an Arbitration Bill of Rights should be passed to ensure that the process of arbitration itself is fair for those who choose it as an alternative to litigation.

Public Citizen believes all of these provisions would provide the protections that small businesses, such as auto dealers, need against the inequities of forced arbitration. Moreover, they would extend to consumers and employers as well.

Pending consideration of that comprehensive solution, we urge to broaden your consideration of the arbitration crisis and pass legislation like S. 121, the Civil Rights Procedures Protection Act of 1999 and S. 2117, the Consumer Credit Fair Dispute Resolution Act of 2000. These pro-consumer, pro-worker bills would address two areas of law where arbitration is exceptionally inequitable. If the Committee is intent on pursuing as free standing legislation, Public Citizen believes it should be amended to protect consumers from arbitration clauses in their contracts with the businesses who would be protected from arbitration by this Bill.

Great News for Alabama Dealers

U.S. Supreme Court Decision on Arbitration

The United States Supreme Court has overturned an Alabama Supreme Court decision that had virtually eliminated any opportunity for Alabama vehicle dealers to use arbitration clauses in their contracts. It now appears that dealers may be able to utilize arbitration clauses and substantially reduce the likelihood of sustaining large punitive damage judgements.

Since 1990, the Alabama Supreme Court has essentially ruled that a transaction must involve substantial interstate commerce and that the parties involved must contemplate interstate commerce for an arbitration clause to be enforceable.

But in Allied-Bruce Terminix v. Dobson (No. 93-1001) decided January 18, 1995, the U.S. Supreme court ruled that the Federal Arbitration act applies in contracts involving interstate commerce no matter what the contract signers intended as to the interstate commerce requirement. According to the court, the transaction need only "affect" interstate commerce. Since vehicles are made in states other than Alabama, this interstate commerce involvement would presumably allow dealers to enforce arbitration agreements.

Association Attorney John Martin Galese has advise dealers to use arbitration agreements even aftet the Alabama Supreme court rule against the arbitration.

"While arbitration may not save a significant amount of money in legal fees or administrative costs, it substantially reduces the likelihood of receiving the type of huge judgements that Alabama juries frequently return."

Your Association attorney has provided us with the correct arbitration language. A copy of this is available by contacting the Association Office.

This arbitration agreement provides that if the customer and the dealer have any type of dispute arising out of the sale or lease of the vehicle, the parties will resolve it through arbitration rather than through the court system.

Arbitration must be agreed to at the time of sale or lease, not when the dispute occurs. The arbitration agreement may completed as a separate document or on the Buyer's Order or lease agreement. In either case, the customer should sign ot initial the provision to further ensure his concurrence to its terms.

While arbitration will not solve the serious legal crisis facing dealers and other business people in Alabama, it could significantly help. ■

INFINITI.

*NO ARBITRATION (please see reverse side)

Dr. Rick McBride
828 Washington Ave.
Montgomery, AL 36104

Dear Dr. McBride,

We would like to introduce ourselves. We our sales and leasing representatives with Brewbaker Infiniti.

Infiniti is regarded as one of the best luxury vehicles on the market today. Infiniti makes four models which include the Sporty G20, the all new I30, the Full-size Q45 and the QX4 Luxury Sport Utility Vehicle.

Please keep in mind some of the advantages of owning an Infiniti: with the service loan car program, you will have a loaner car waiting on you when you bring yours in for service, with the warranty, Infiniti includes a 4yr/60,000 miles bumper to bumper warranty and a 6yr/70,000 miles power train warranty. Also you get roadside assistance for 4yrs/unlimited mileage. These are benefits that are standard on all Infinitis.

We invite you to come by Brewbaker Infiniti to take a test drive. If you would like for us to send a brochure on one of our models, just give us a call. Enclosed is our business cards. Please ask for either of us when you call or come by.

Sincerely,

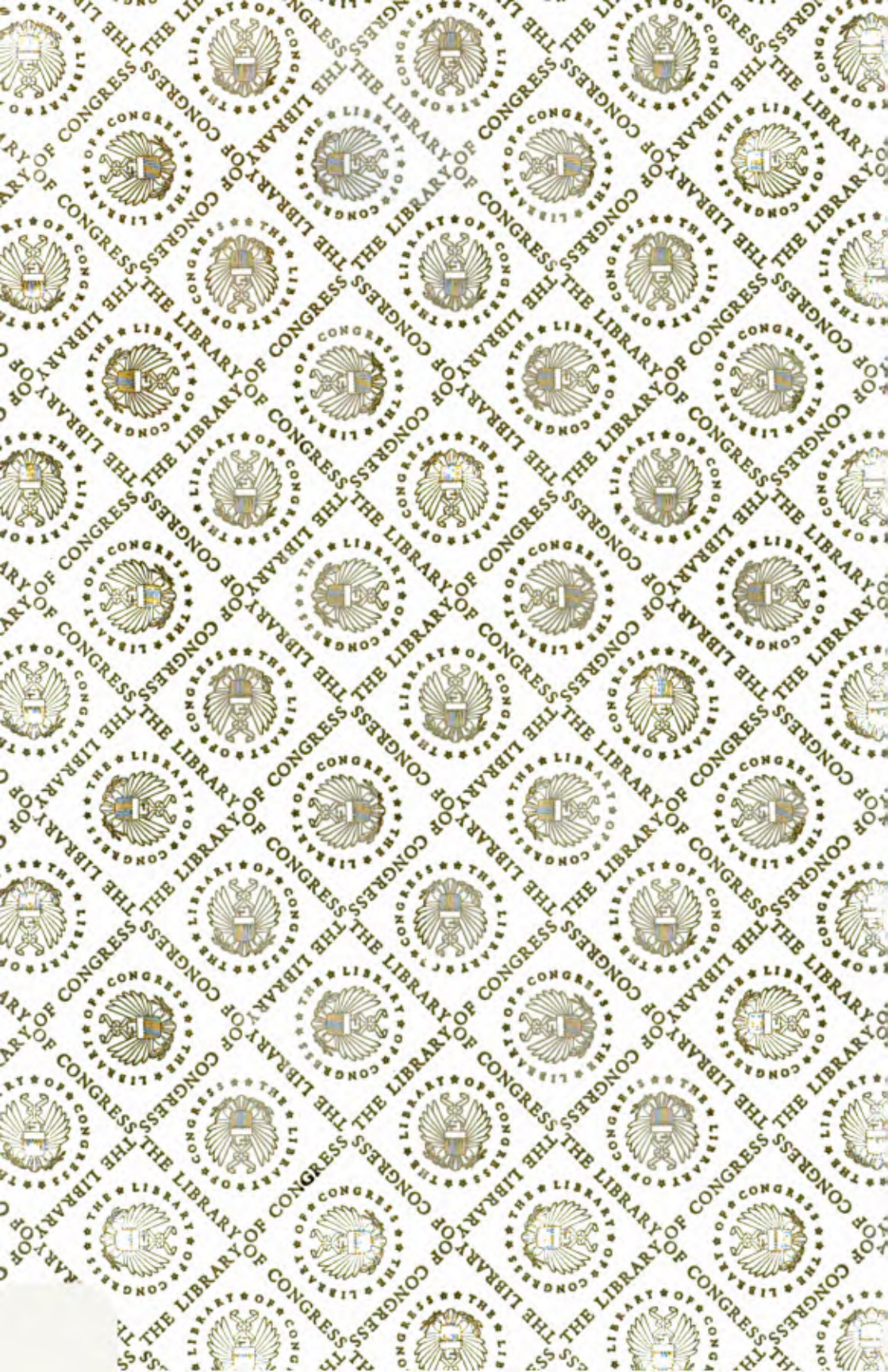
Buck Franklin
Melanie Morrison

BREWBAKER MOTORS, INC.
220 EASTERN BOULEVARD • MONTGOMERY, ALABAMA 36117
(334) 260-2089 • FAX (334) 260-2083

ARBITRATION POLICY

We are advertising "no arbitration on new Infiniti's." This is effective immediately. Here are the highlights

1. Arbitration is no longer required on new Infiniti sales. This applies to NEW Intinifi's only. Used Infiniti's and other franchises still require arbitration.
2. Arbitration will be required on new Infiniti's if:
   a. If delivery is made off Brewbaker Motors property.
   b. If delivery is made after normal business hours.
   c. If there is some condition that prevents us from recording the closing orb if the customer refuses to let us do the recording.
3. The arbitration requirement on repair orders and body shop tickets remains in place.
4. We will still ask customers to sign arbitration. but it will not be a condition of sale.
5. Customers should realize that certain other contracts (bank finance contracts, etc.) may contain arbitration agreements. Brewbaker Motors has no authority to alter such contracts.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